APPENDIX

# Supreme Court of the United States

OCTOBER TERM, 1972

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No. 72–1490

FEDERAL POWER COMMISSION, *PETITIONER*

v.

TEXACO INC., *ET AL.*

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No. 72–1491

DUDLEY T. DOUGHERTY, *ET AL.*, CO-EXECUTORS, ESTATE OF MRS. JAMES R. DOUGHERTY, *ET AL.*, *PETITIONER*

v.

TEXACO INC., *ET AL.*

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ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

(18 CFR Parts 154, 157 and 250)

Exemption of Small Producers )
From Regulation )
Docket No. R-393

# NOTICE OF PROPOSED RULEMAKING

(July 23, 1970)

Notice is hereby given pursuant to 5 U.S.C. 553 and Sections 4, 5, 7 and 16 of the Natural Gas Act that the Commission proposes prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers, as hereinafter defined. This would not include percentage sales made by small producers pursuant to percentage sales contracts. Nor would it include sales to interstate pipeline companies by their affiliates.

As a result of the promulgation of Section 157.40 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.40) in Order No. 308 issued October 29, 1965 (34 FPC 1202) small producers were accorded some relief from the filing requirements in Sections 4 and 7 of the Natural Gas Act for sales in the Permian Basin area. The groundwork for this relief was formulated in Opinion No. 468 (34 FPC 169). Subsequently, the same treatment was extended to sales in Southern Louisiana in Opinion No. 546 (40 FPC 530). Specifically, if a producer receives a small producer certificate pursuant to Section 157.40, it may commence new jurisdictional sales in the Permian and Southern Louisiana areas at rates no higher than the applicable just and reasonable base rates determined in Opinion Nos. 468 and 546, respectively (plus upward Btu adjustment for first and second vintage sales in Southern Louisiana). Such a certificate also eliminates the need for filing

(1)

quality statements with respect to existing sales where otherwise required by those

[2]

opinions, but this is significant only where the gas is below pipeline quality. It also obviates the need for a rate change filing up to the applicable ceiling but this is of little importance since there are few small producers collecting rates below the applicable ceiling who are contractually entitled to higher rates. The relief previously granted has been inadequate for small producers since they still bear many of the expenses and burdens of complying with regulatory requirements, particularly when they seek the same treatment accorded large producers. Such relief has also increased the difficulties inherent in processing small producer filings from an administrative viewpoint instead of decreasing these problems as was intended.

Mr. Justice Clark speaking for the Court in *F.P.C. v. Hunt*, 376 U.S. 515 (1964) recommended that the Commission consider procedures for the exemption of small producers. Our present proposal would relieve small producers in all areas of almost all of the expenses and burdens connected with regulatory matters after exemption is authorized. It should also facilitate more effective regulation of large producers by permitting us to expend our efforts with respect to natural gas production exclusively on such large producers. Small producers account for a relatively small share of the natural gas produced nationally. Moreover, as a practical matter, the small producer is normally not in a position to obtain more for the sale of its gas than the large producer whose jurisdictional sales are subject to the ceilings prescribed by the Commission in each area. The impact on the consumer of exempting small producers from regulation should thus be minimal. The exemption of small producers should also encourage them to increase their exploratory efforts which are important in the discoveries of new sources of gas.

Under our proposal small producers upon application therefor will be exempted by Commission order from all provisions of the Natural Gas Act and the Commission's Regulations otherwise applicable to the jurisdictional sales covered by such exemptions,

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except for the requirement that they submit annually a document setting forth their total volume of jurisdictional sales. The exemption so ordered would continue as long as the small producer's jurisdictional sales do not exceed 10,000,000 Mcf in a calendar year when aggregated with all jurisdictional sales of affiliates as hereinafter defined. Should a producer cease to qualify as a small producer, it would be required to file separate certificate applications and individual rate schedules for future sales but the exemption previously granted would remain in effect for sales made under contracts dated prior to such termination.

If the rules proposed here are adopted, any order granting exemption to a small producer pursuant to such rules would provide for the exemption to be effective 45 days after the issuance of such order. In this connection we propose to allow pipeline purchasers to file rate increases which are limited to tracking rate increases resulting from the exemption of small producers by waiving, where necessary, the requirement for supporting schedules under Section 154.63 of our Regulations (18 CFR 154.63), provided such schedules are submitted within four months from the date of the pipeline's increased rate filing. Producers who have received small producer certificates under the present provisions of Section 157.40 or who have applied and qualify but have not yet received such a certificate would not be required to file new applications unless otherwise directed in any order issued herein.

The exemption for small producers proposed here would include, *inter alia*, jurisdictional sales made by a small producer to a large producer. However, the resale of such gas by the large

(3)

producer would remain subject to our jurisdiction. If there are any problems in this regard, large producers in their comments should discuss these problems.

We have not proposed any disposition of increased rates collected subject to refund in Section 4(e) cases or initial rates collected under temporary certificates issued pursuant to Section 7 by small producers for the period prior to the effective date of the exemption. The proceedings to which we refer here are those proceedings where the Commission has not

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yet taken any action and none is now pending as a result of an examiner's decision. Interested parties, however, in their comments are invited to address themselves to the questions of terminating such proceedings and relieving the small producers of any potential refund obligation therein.

Accordingly it is proposed to amend Part 154, Rate Schedules and Tariffs, Part 157, Applications for Certificates of Public Convenience and Necessity and for Orders Permitting and Approving Abandonment under Section 7 of the Natural Gas Act, and Part 250, Forms, in Chapter 1, Title 18 of the Code of Federal Regulations in the manner set forth below.

The Commission also proposes to waive the provisions of Section 154.63 of the Commission's Regulations under the Natural Gas Act solely to the extent necessary to permit the tracking by pipeline purchasers and by pipelines purchasing from such pipeline purchasers of rate increases resulting from the exemption of small producers, *provided* that with respect to such pipelines which are not presently authorized to track supplier increases either through approved settlements or outstanding orders of the Commission the supporting schedules required by Section 154.63 shall be filed within four months from the date of such pipeline increased rate filing; and provided further that the rate or rates as revised by such tracking filings shall be collected subject to reduction and refund from the effective date of such increased rate or rates.

The proposed amendments to Parts 154 and 157 of Subchapter E, Regulations under the Natural Gas Act, and to Part 250 of Subchapter G, Approved Forms, Natural Gas Act, Chapter 1, Title 18 of the Code of Federal Regulations would be issued under the authority granted the Federal Power Commission by the Natural Gas Act, particularly sections 4, 5, 7 and 16 (52 Stat. 822, 823, 824, 825, 830, 56 Stat. 83, 84, 61 Stat. 459, 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o).

[5]

All interested persons may submit to the Federal Power Commission, Washington, D.C. 20426, not later than September 8, 1970, data, views, comments, and suggestions, in writing, concerning the proposed amendments to the regulations and the proposed exemption application and annual statement forms. An original and nine conformed copies should be filed with the Commission. In addition, interested persons wishing to have their comments considered in the clearance of the proposed exemption application and annual statement forms under the provisions of the Federal Reports Act of 1942 may at the same time submit a conformed copy of their comments directly to the Clearance Officer, Office of Statistical Standards, Office of Management and Budget, Washington, D.C. 20503. Submissions to the Commission should indicate the name and address of the person to whom correspondence in regard to the proposal should be addressed, and whether the person filing them requests a conference at the Federal Power Commission to discuss the proposed amendments to the regulations and the proposed forms. The Commission will consider all such written submissions before acting on the matters herein proposed.

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A. The following are proposed amendments to Part 157. Chapter 1, Title 18 of the Code of Federal Regulations.

1. Revise "§ 157.40, Small producer certificates of public convenience and necessity" so that it will read as follows:

§ 157.40 Exemption of small producers

(a) *Definitions.*

(1) A 'Small Producer' is an independent producer of natural gas as defined in § 154.91 of this chapter, who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of 'affiliated producers' are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year. As used in this section, the term 'jurisdictional sales' includes volumes of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this section has an interest in such sales, but does not include sales made pursuant to percentage sales contracts.

(2) 'Affiliated producers' are persons who, directly or indirectly, control, or are controlled by, or are under common control with, the applicant producer. Such control exists if the producer has the power to direct or cause the direction of, or as a matter of actual practice does direct, the management and policies of a person, whether such power is exercised alone or through one or more intermediary companies, or pursuant to an agreement, and whether such power or practice is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, relationship of blood or marriage, or any other direct or indirect means. For the further purposes of this section, the term 'agreement' shall not include any agreement for the

'agreement' shall not include any agreement for the

[7]

operation of a natural gas producing property or a plant processing natural gas unless such agreement otherwise establishes the power to direct or cause the direction of the management and policy of a person.

(3) 'Small producer sales' are (i) sales by a small producer of his own interests under his own contracts; (ii) sales of all interests under a small producer's contract if producers not qualifying as small producers have interests which in the aggregate are no greater than 12-½ percent; and (iii) sales of a small producer's interests under another producer's contract.

(b) *Requirements for exemption.* Upon the approval of appropriate applications made pursuant to the provisions of this section, Small Producers will be granted exemption with respect to their 'small producer sales' of natural gas in interstate commerce.

(1) Small Producers may apply for exemption to cover all previous and all future jurisdictional sales, which do not raise the producer's total jurisdictional sales on a nationwide basis above 10,000,000 Mcf during any calendar year. Applications by these producers shall include the following information: (i) total jurisdictional sales on a nationwide basis for the year preceding the application; (ii) a list of outstanding certificates and rate schedules together with names and percentage of interest of other interest owners under such rate schedules; (iii) a list of outstanding rate schedules of others in which applicant owns an interest together with applicant's percentage of interest; and (iv) the names of all owners (stockholders, partners, joint venturers, etc.) of the applicant with an interest of 10 percent or more,

their percentage of ownership in the applicant and in any other natural gas company, and

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any positions such owners may hold with another natural gas company.

(2) An applicant for exemption who has no outstanding certificate issued by, or rate schedule filed with, this Commission for the sale of natural gas shall include the following information in his application:

(i) a list of all contracts to sell natural gas in interstate commerce,

(ii) source of production, total rate and the annual volume delivery obligations of the producer under each such contract, together with names and percentage of interest of other interest owners under each such contract, and

(iii) a list of owners of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company and any position such owners may hold with another natural gas company.

(3) The application shall contain the information required by the form set out in § 250.10 of this chapter. A conformed copy shall be served upon each of the applicant's purchasers.

(c) *Duration of the exemption.* The exemption authorized hereunder shall remain in effect for small producer sales until the Commission on its own motion or on application terminates such certificate because the producer no longer qualifies as a small producer or fails

to comply with the terms of the exemption. Upon such termination the producer will be required to file separate certificate applications and individual rate schedules for future sales but the exemption will still be effective as to those made under contracts dated prior to such termination.

B. The following are proposed amendments to Part 154, Chapter 1, Title 18 of the Code of Federal Regulations.

1. Revise paragraph (f) of § 154.91, § 154.104 and § 154.110. As revised, these portions of Part 154 will read:

§ 154.91 Applicability.

* * * * *

(f) *Filings by certain non-signatories.* Where the operator and the signatory co-owners in a particular sale have secured exemption pursuant to § 157.40 covering the sale, and where any non-signatory co-owner's interests are not covered by such exemption, such co-owner may file rate schedules, rate changes, or certificate applications with respect to such interests notwithstanding the provisions of paragraph (d) of this section.

* * * * *

§ 154.104 Annual statements by small producers.

Annual statements certifying to the matters enumerated in the form set out in § 250.11 of this chapter shall be filed by all producers, either individually or by groups, who have been exempted under the provisions of Section 157.40. The statements shall be submitted by April 1 of each year for the preceding calendar year.

§ 154.110 Applicability of §§ 154.92 through 154.102.

Sections 154.92 through 154.102 shall apply only to those persons specified in § 154.91 and shall not apply to small producer sales which are exempted under § 157.40 of this chapter."

C. The following are proposed amendments to Part 250, Forms, Chapter 1, Title 18 of the Code of Federal Regulations.

1. Revise the title of § 250.10 so that it will read:

§ 250.10 Application for small producer exemption.

Revise the test of § 250.10 by substituting therefor the proposed form entitled "Application for Small Producer Exemption" all as set out in Attachment A hereto.

2. Revise the title of § 250.11 so that it will read:

§ 250.11 Annual statement for independent producers holding small producer exemptions.

Revise the text of § 250.11 by substituting therefor the proposed form entitled "Annual statement for independent producers holding small producer exemptions" all as set out in Attachment B hereto.

The Secretary shall cause prompt publication of this notice to be made in the Federal Register.

By direction of the Commission.

Gordon M. Grant,
Secretary

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§ 250.10

# APPLICATION FOR SMALL PRODUCER EXEMPTION

(See § 157.40(b)(3))

NOTE: Independent Producers of natural gas whose total jurisdictional sales on a nationwide basis for the preceding calendar year, combined with those of "affiliated producers," were not in excess of 10,000,000 Mcf may file the information called for in this form for a Small Producer Exemption to sell gas (in four copies). Include volume of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this Section 157.40 has an interest in such sales. Do not include sales made pursuant to percentage sales contracts. If insufficient space is given for a complete answer, continue the answer on the reverse side or on a separate sheet, noting the relevant number.

| | |
|---|---|
| 1. NAME OF APPLICANT | 2. STATE OF ORGANIZATION |
| 3. LOCATION OF PRINCIPAL PLACE OF BUSINESS | 4. TYPE OF ORGANIZATION (Corporation, partnership, joint venture, etc) |

5. PERSON RESPONSIBLE FOR APPLICATION

| | |
|---|---|
| NAME AND TITLE | MAILING ADDRESS |

6. TOTAL JURISDICTIONAL SALES VOLUMES AT ______ PSIA FOR CALENDAR YEAR PRECEDING APPLICATION. (If more than one applicant is to be covered by this exemption, give the total jurisdictional sales volumes of each applicant separately.)

7. LIST ALL CERTIFICATES PRESENTLY HELD BY [illegible] AND LIST ALL [illegible] ON FILE WITH THE COMMISSION AS RATE SCHEDULES BY RATE SCHEDULE NUMBER AND [illegible]. INCLUDE IN SUCH LISTING APPLICANTS' INTERESTS IN GAS SALES COVERED BY OTHER PRODUCERS' CERTIFICATES AND RATE SCHEDULES. LIST ALL INTEREST OWNERS AND THE AMOUNT OF THEIR INTEREST FOR EACH SALE TO BE COVERED BY THIS EXEMPTION. (See reverse side for reporting)

8. LIST ALL OWNERS OF MORE THAN 10 PERCENT INTEREST IN APPLICANT: (A) INDIVIDUAL NAME; (B) PERCENT OF OWNERSHIP

9. LIST ALL INTEREST HELD BY THE INDIVIDUALLY NAMED OWNERS IN OTHER NATURAL GAS COMPANIES: (A) INDIVIDUAL NAME; (B) COMPANY NAMES; (C) PERCENT OF APPLICANT OWNERSHIP.

10. LIST FOR EACH OWNER THE POSITIONS HELD BY THESE INDIVIDUAL OWNERS IN APPLICANT COMPANY OR ANY OTHER NATURAL GAS COMPANY.

11. IS APPLICANT OR ANY INDIVIDUAL OWNER LISTED, AFFILIATED WITH ANY PURCHASER OF JURISDICTIONAL GAS FROM APPLICANT (If so list name of buyer and seller for each sale and nature of affiliation.)

| | | |
|---|---|---|
| SIGNATURE | TITLE | DATE |

FPC Form [illegible]
Rev (6-72)

SALES UNDER RATE SCHEDULE OF APPLICANT

| APPLICANT | DOCKET NUMBER | RATE SCHEDULE NUMBER | CURRENT OWNERSHIP UNDER [illegible]'S CONTRACT | |
|---|---|---|---|---|
| | | | NAME | PERCENT INTEREST |

APPLICANT'S SALES UNDER RATE SCHEDULE OF OTHERS

| OTHER SELLER | DOCKET NUMBER | RATE SCHEDULE NUMBER | APPLICANT'S PERCENT INTEREST IN RATE SCHEDULE |
|---|---|---|---|

NOTE: Place an asterisk (*) after each co-owner name whose interest is not to be covered by the Small Producer Exemption applied for.

FPC Form [illegible]
Rev [illegible]

Attachment A - Page 1 of 1

§250.11 Annual Statement for Independent Producers holding Small Producers Exemptions.

(See § 157.40 of this chapter)

I hereby certify that total sales subject to the jurisdiction of the Federal Power Commission made by the undersigned and its affiliates for the calendar year 19__ were ____________________ Mcf at 14.65 psia. The pertinent information relating to each of these jurisdictional sales is as follows:

| Area | Purchaser | Volume | Price |
|---|---|---|---|

______________________________
(Name of Small Producer)

______________________________
(Signed)

______________________________
(Representative Capacity)

______________________________
(Docket No.)

FPC Form 314-B
(3-71)

[14]

BEFORE THE

FEDERAL POWER COMMISSION

| | |
|---|---|
| Initial Rates for Future Sales of Natural Gas ) | Docket No. R-389A |
| Exemption of Small Producers from Regulation ) | Docket No. R-393 |
| Termination of Moratorium in Southern Louisiana ) | Docket No. R-394 |

RESPONSE OF NEW YORK COMMISSION
AND MOTION TO DISMISS

Just six weeks ago, Judge J. Skelly Wright, speaking for a unanimous panel of the United States Court of Appeals for the District of Columbia Circuit, began his landmark decision in *Moss* v. *C.A.B.*, D. C. Cir. No. 23627 (July 9, 1970), with this stark and incisive statement of the issue:

> "This appeal presents the recurring question which has plagued public regulation of industry: whether the regulatory agency is unduly oriented toward the interests of the industry it is designed to regulate, rather than the public interest it is designed to protect."

Answering this question in the affirmative in *Moss*, the Court found that the CAB, in granting the airline industry rate increases without following the proper hearing requirements, had demonstrated that it was unduly oriented toward the

regulated industry and insensitive to the airline-riding public;* accordingly, the Court invalidated the Board's order granting increases and remanded the case for further proceedings.

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With the ink not yet dry on Judge Wright's decision in *Moss*, the Federal Power Commission, in a series of three notices of proposed rulemaking issued during the latter half of July, has proposed, without statutory authorization, to dismantle regulation of rates charged by producers for the interstate sale of natural gas at the wellhead. The entire program–which hardly reads like the work product of a government agency charged by law to assure consumers "a complete, permanent and effective bond of protection from excessive rates and charges," *Catco*, 360 U.S. 378 at 388–is of highly questionable legality, is patently unwise, and, because of its present deleterious effects, should be abandoned at the earliest possible moment.

It is ten years since the late Dean Landis, in his memorable Report on Regulatory Agencies to the President-Elect, witheringly observed:

> "The Federal Power Commission without question represents the outstanding example in the federal government of the breakdown of the administrative process . . .
>
> "These defects stem from attitudes, plainly evident on the record, of the unwillingness of the Commission to assume its responsibilities under the

* After all, there is more to rate-making than providing carriers with sufficient revenue to meet their obligations to their creditors and to their stockholders." *Moss*, slip op. p. 20.

Natural Gas Act and its attitude, substantially contemptuous, of refusing in substance to obey the mandates of the Supreme Court of the United States and other federal courts.

* * *

"... The Commission's past inaction and past disregard of the consumer interest has led the states to seek to force it to discharge its responsibilities. It is somewhat of a phenomenon in our national life for the state utility commissions to be ranged against a federal commission in an effort to protect consumers against monopolistic and excessive rates ..." Landis Report, 54-56.

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The current regulatory picture–as revealed by the three rulemaking notices–is in many respects more distressing than it was at the time of the Landis Report. Whereas in 1960 the Commission could be criticized for its failure to fix just and reasonable wellhead prices, today the criticism is that, having finally determined just and reasonable area rates and having been sustained on appeal, the Commission now proposes to abandon the rates thus determined and escalate sharply the prices to be charged the consumer. And the Commission's sole basis for this proposed abandonment of its regulatory responsibility is the current gas supply situation as it relates to the interstate market. Yet the Commission has failed to act on the New York Commission's request, filed over eighteen months ago, for an investigation into the adequacy of natural gas reserves (Docket No. R169-470) and, without either investigating the causes of the supply situation or inviting the Justice Department to do so, has simply assumed that the shortage has been caused by the prices fixed by the Commission in its September 1968 opinion in the Southern Louisiana Area Rate Proceeding.

If, however, the shortage has not been caused by the price set in Opinion No. 546, then it necessarily follows that the shortage cannot and should not be solved by elevating those prices. As the Honorable George P. Shultz–surely the highest-ranking economist in the administration–has recently testified,* the petroleum industry

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> "is capable of behaving irrationally for short periods, and even of contriving an apparent disaster by ceasing exploration [and] dramatically revising its reserve additions downward . . . [Such industry action could] produce an appearance of crisis calling for immediate 'corrective' action, e.g., . . . higher prices . . ."

Secretary Shultz expressly warned of the difficulty of distinguishing between "a fake disaster and a real one" since "the 'facts' for decision will be produced largely by these same firms and associations."

Until the Commission has satisfied itself on the basis of testimony that has been subjected to cross-examination that (1) the present gas shortage has been caused by unduly low interstate price ceilings, (2) that the shortage will be eliminated or at least substantially alleviated by higher ceilings, and (3) that the cost placed on the consumer of the higher ceilings is not disproportionate to the volume of new supplies, the Commission should not, and cannot lawfully, tamper with its present ceilings.

In the fifteen years following the Supreme Court's *Phillips* decision, when consumers were seeking relief from excessive

* Testimony before Senate Judiciary Subcommittee on Antitrust and Monopoly, March 3, 1970.

producer prices, no reductions in any producer prices was made until after the producer had been granted a full hearing, the examiner had issued a decision, the case had been argued to the Commission, and the Commission had fully deliberated and entered an opinion. And even then, stays of the reductions were granted pending judicial review. (And, in the case of the important Southern Louisiana area, reductions continue to be stayed even after judicial affirmance.) In contrast, when the industry demands an increase in the ceilings, the Commission proposes that it be granted *instanter*–without hearing,



without proof, without possibility of refund. This disparate treatment of consumer and industry claims can hardly be expected to inspire confidence in the administrative process.

We turn now to certain of the more glaring defects in the three rulemaking dockets.

*R-389A: Increased Initial Rates*

1. The Commission's intention to permit, via rulemaking, higher new gas rates that "will be firm rates, not subject to refund" violates the Commission's statutory obligation to protect the consumer from excessive rates, as explicated in considerable detail by the Supreme Court in *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (1959).

2. We believe that any determination to allow a higher rate of return in the computation of unit costs than that allowed in Opinion No. 546 should rest upon an evidentiary record.

3. We believe that the Federal Power Commission can give no significant weight to market price or commodity value

concepts. The basic function of regulation is to establish a price other than what would obtain in the absence of regulation, but "market price" merely defines what the unregulated price would be.

*R-393: Small Producer Exemption*

1. No rational basis has been shown to justify exemption of small producers. The procedures for small producers established in *Permian* and *Southern Louisiana* reduce the regulatory burden on those producers

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to a minimum so long as they receive no more than the area rate ceilings. There is no visible support for the claim that "the relief previously granted has been inadequate for small producers." Nor is there visible support for the implication that present regulation of small producers has absorbed any significant time of the FPC staff so that "more effective regulation of large producers would result" if small producers were exempted.

2. The Commission's contention that "the small producer is normally not in a position to obtain more for the sale of its gas than the large producer" has little present relevance, for in fact these are not normal times. As the Commission well knows, necessitous buyers have been willing to pay 10¢ or more above the FPC ceilings to meet shortages, see, e.g., emergency purchases by Natural Gas Pipeline Co. purportedly pursuant to Order No. 402. An increase of 10¢ per Mcf on the 15% of the gas sold by small producers would equal an additional $180,000,000 to be borne by gas consumers.

3. It is difficult to square the Commission's present willingness to create a regulatory gap over 15% of the gas sold interstate with its vigorous refusal to allow a regulatory gap over the 4% of the gas used for compressor fuel, *California* v. *Lo Vaca*

*Gathering Co.*, 379 U.S. 366 (1965).

4. The proposed rule opens the way for the major producers to sell their gas in interstate commerce free from FPC regulation by selling their reserves in place to small (or non-) producers, who would in turn resell the reserves under a conventional sales contract to an interstate pipeline.

[20]

*R-394: Termination of Moratorium*

The Commission's notice sets forth no rational basis for lifting the moratorium provisions of Opinion No. 546. The entire thesis of the two-price system in area ratemaking was that the incentive function was to be provided by the new gas price. Raising the price of flowing gas will merely enrich the oil industry and provide it with additional funds to build refineries or tankers or explore in the North Sea. The Commission's assertions that there are "indications of cost increases" which have affected exploration can refer only to increases in the costs of new gas; there are no indications that the costs of flowing gas, determined by Opinion No. 546, have risen above the rates fixed by that opinion. (It should be noted that the rates in Opinion No. 546 were fixed in excess of costs to take into account future cost increases.) If, and it is a highly unlikely if, the costs of flowing gas exceed the area ceilings, the producers have a present forum, in AR69-1, to so demonstrate. Abolition of the moratorium provisions would not generate additional supplies, but would merely burden the consumer with higher prices.

In view of the foregoing, the Public Service Commission of the State of New York respectfully requests that the Commission dismiss the rulemaking dockets at R-389A, R-393, and R-394. In view of the importance of the questions raised by this

motion, we respectfully request that it be set for oral argument.

Respectfully submitted,

PUBLIC SERVICE COMMISSION
OF THE STATE OF NEW YORK

By /s/ Kent H. Brown
Kent H. Brown, Counsel
44 Holland Avenue

Morton L. Simons
1819 H Street, N.W.

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

| | | |
|---|---|---|
| Exemption of Small | ) | |
| Producers from | ) | Docket No. R-393 |
| Regulation | ) | |

COMMENTS OF
PHILLIPS PETROLEUM COMPANY

Pursuant to Notice in this proceeding issued July 23, 1970, Phillips Petroleum Company (Phillips) submits herewith its comments upon and objections to the proposed rule-making. Correspondence in regard to this proposal should be addressed to the following:

Kenneth Heady
Legal Department
Phillips Petroleum Company
Bartlesville, Oklahoma 74004

Sam Jennings
Manager, Laws and Regulations Division
Gas and Gas Liquids Department
Phillips Petroleum Company
Bartlesville, Oklahoma 74004

Because of the objections raised herein, Phillips requests that a conference be held to discuss the proposed amendments to the regulations and that the persons above named be notified of the time and place of such conference.

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Phillips expresses no objection to the desires of the Commission to relieve small producers "of the expenses and burdens connected with regulatory matters", except to note that such expenses and burdens constitute an equal deterrent to large producers to the commitment of their gas in interstate

commerce. To the extent that the proposed rule-making contemplates higher prices for small producers than large producers, however, Phillips believes that the proposed regulations are both unwise and unlawful. If the Commission seeks amendments to its regulations which will foster an increase in exploratory efforts for natural gas and an increase in commitments of the results of such efforts to interstate commerce, the Commission's action is misguided and misdirected. The ills of a nationwide gas shortage may not be cured by attempts to hide the symptoms. Efforts of interstate purchasers to obtain new commitments of natural gas reserves will not be aided by the proposed regulations. On the contrary, the proposed regulations will constitute the greatest incentive to intrastate sales by large producers since Opinion 468.

[51]

1. <u>Receipt by Small Producers of Above-ceiling Prices Demonstrates That Ceiling Prices to Large Producers Are Too Low.</u>

Exemption of small producers from price ceilings applicable to large producers presents an inexplicable paradox. On the one hand, the Commission recognizes that, "... as a practical matter, the small producer is normally not in a position to obtain more for the sale of its gas than the large producer whose jurisdictional sales are subject to the ceilings prescribed by the Commission in each area." On the other hand, the Commission expects that, "The exemption of small producers should also encourage them to increase their exploratory efforts which are important in the discoveries of new sources of gas." Either the small producer will in fact receive such above-ceiling prices, then the exemption amounts to no more than relief from "the expenses and burdens of complying with regulatory requirements", and the effects upon exploration may be expected to be minimal. On the other hand, if the small producer does receive above-ceiling prices, the willingness of pipeline purchasers to pay such above-ceiling prices rests upon factors totally unrelated to the circumstance that the sale is by a small producer.

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Underlying the philosophy that the Commission may permit small producers to receive above-ceiling prices is the wholly fallacious concept that large producers may, directly or indirectly, be forced to sell their gas in interstate commerce at an artifically restricted price. There is no logical reason why an interstate purchaser would willingly pay a small producer more for a small quantity of gas than it would pay a large producer for a substantial quantity of identical quality gas. Payment of such above-ceiling prices to small producers would simply constitute irrefutable proof that the regulated ceiling price was too low to induce a commitment of gas into interstate commerce. It is wholly illogical to assume that a large producer would be inspired and induced to carry on an expensive exploratory program and commit his resulting discoveries of gas into interstate commerce at prices which are unacceptable to and refused by small producers.

If in fact small producers should regularly be offered and receive above-ceiling prices, large producers would have no alternative except to seek to protect themselves from the innumerable problems arising from such price differentials. Under the trend of recent court decisions, payments of above-ceiling prices to small producers might well establish market values for royalty purposes applicable to large producers. Cf. *J.M. Huber Corporation* v. *Denman*, 367 F.2d 104;

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*Texas Oil & Gas Corporation* v. *Vela*, 429 SW 2d 866. In this respect, this Commission's decision in Opinion No. 562, *Denman, et al.* v. *J. M. Huber Corporation, et al.*, ____FPC____, is likely to create rather than resolve confusion. It certainly is not inconceivable that knowledgeable royalty owners would refuse to grant oil and gas leases to large producers, preferring to reap the advantages of unrestricted sales by small producers. State tax collectors may likewise decide that values for tax purposes are fixed by sales by small producers rather than regulated ceiling prices applicable to large producers.

These circumstances, alone or in combination, would virtually drive large producers to seek unregulated markets for

their gas in order to maintain parity with small producers. The Commission recognizes in its Notice that "small producers account for a relatively small share of the natural gas produced nationally", yet by this proposed regulation the Commission seems determined to limit the supplies of gas available for the interstate market to that small share produced by small producers.

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Contentions will be made that these dire predictions will not come to pass. But the issue is not whether they will or will not. The issue is whether exemption of small producers will serve any useful purpose. If in fact small producers achieve substantially higher prices than large producers, then the predictions herein made are a distinct possibility. If in fact small producers do not realize any appreciable benefits from exemption from regulation, then these regulations will have served no useful purpose.

Objectives sought by exemption of small producers are laudable, but we believe the Commission is misdirecting its efforts. Substantial increases in exploration, which is the ultimate end sought, can be realized only by higher ceiling prices applicable to all producers, not just to exempted small producers.

2. The Proposed Regulations Unlawfully Discriminate Against Phillips.

The proposed regulations are patently and unlawfully discriminatory as to Phillips and other large producers who

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are engaged in the purchase of natural gas for processing and resale. Page 3 of the Notice states:

> "The exemption for small producers proposed here would include, *inter alia*, jurisdictional sales made by a small producer to a large producer. However, the resale of such gas by the large producer would remain subject to our jurisdiction. If there are any problems in this regard, large producers in their comments should discuss these problems."

Problems abound for large producers in this proposal. Phillips has long been engaged in the business of purchasing and processing natural gas for the extraction of natural gas liquids and resale of the remaining residue gas. Extraction of natural gas liquids is a business separate and apart from the sale of natural gas. *Phillips Petroleum Company*, Opinion No. 338, 24 FPC 537, 562. If this proposed regulation were to become operative, Phillips either would not be able to purchase gas from small producers at all or would be forced to purchase gas at prices more than it could permissibly receive for the resale of such gas. In either event, the proposal seems designed to drive Phillips from the business of extracting natural gas liquids from purchased gas.

In fact, the Commission here seems to be executing the veiled threat first made in the *Permian Basin Decision*, Opinion No. 468. The Commission there stated:

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> "Hunt urges that residue gas must be priced higher than gas-well gas so that a processor selling residue gas can cover his processing costs plus a return on his investment in addition to the price of the gas-well gas he purchases. This reasoning ignores the fact that salable liquid hydrocarbons are derived from the gas that is processed. The principal purpose of such processing is the removal of these liquids so that revenue may be realized from them. There is every reason to believe that the value of the liquids will be sufficient to justify gasoline plant processing of new gas-well gas. If not, there is no apparent economic reason to encourage the processing at gasoline plants." (34 FPC at 211)

The proposed regulations make sheer mockery of the statement, "There is every reason to believe that the value of the liquids will be sufficient to justify gasoline plant processing of new gas-well gas." Under the proposed regulations there is nothing to prevent a pipeline purchaser from paying the small producer an above-ceiling price plus the value of all of the

liquids contained. There is simply no way under such conditions that the producer-plant operator could remain in businesss.

These harsh results are by no means mollified by the statement in the first paragraph of the Notice that the proposed regulations "would not include percentage sales made by

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small producers pursuant to percentage sales contracts." This provision would mean simply that producer-plant operators such as Phillips could purchase gas from small producers under percentage contracts only where no interstate pipeline was willing or able to make such purchase. No rational small producer would choose to sell his gas to Phillips at a percentage of the ceiling price if the gas could be sold to an interstate pipeline at prices well above the ceiling plus liquid values.

Contrast this treatment of large producers with the provisions of page 4 of the Notice applicable to interstate pipelines:

> "The Commission also proposes to waive the provisions of Section 154.63 of the Commission's regulations under the Natural Gas Act solely to the extent necessary to permit the tracking by pipeline purchasers and by pipelines purchasing from such pipeline purchasers of rate increases resulting from the exemption of small producers***"

Discrimination could not be more clearly stated. Pipelines purchasing from small producers are to be held harmless from the increased costs resulting from such purchases. Even those pipelines purchasing from the original

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pipeline purchaser are afforded protection. The large independent producer, on the other hand, is specifically prohibited from increasing its resale rates to take into account higher prices paid to small producers.

Justification for such discrimination does not exist. There is no rational basis for preventing producer-plant operators from increasing their rates to account for above-ceiling rates paid to exempted small producers. Nor is there rational basis for

requiring large producers to bear any portion of this additional expense out of nonjurisdictional liquid revenues. Problems of rate determination for large producers are no more complicated than those for pipelines which are expressly permitted to take such above-ceiling rates into account in fixing their resale rates.

Experience in rate adjustments of this type has already been gained under the regulatory policies imposed by Opinion No. 468. That decision expressly provides that "The ceiling price for new gas-well gas will be applicable to residue gas which is derived from new gas-well gas." (34 FPC at 211) Consequently, new gas-well gas purchased by Phillips from another producer retains its character even though resold by Phillips under a contract applicable to flowing gas. Phillips has filed and the Commission has accepted rate schedules which,

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although generally applicable to flowing gas, specify the higher ceiling rate for that portion of the gas delivered which is purchased from other producers under contracts qualifying such gas as new gas-well gas.

No reason exists or has been suggested why similar modifications could not be made in Phillips' rate schedules to account for above-ceiling rates paid to exempted small producers. For lack of such reason, the proposed regulations must be classed as arbitrary and capricious as well as discriminatory.

Aside from such effects upon Phillips and other large producer-processors of natural gas, the consumer is by no means served by this proposed discrimination against large producers. A very substantial portion of Phillips' present supplies of gas purchased and resold in interstate commerce is represented by purchases of gas from small producers who would be exempted. Generally these contracts are of relatively short duration or have been in effect for a sufficient length of time that these contracts will expire by their own terms in the relatively near future. By virtue of their exemption, these small producers could terminate deliveries to Phillips at the expiration of their contracts.

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For the consumer, such terminations would mean either added costs for both gas and facilities or loss of such gas supplies to intrastate markets. At the end of the contract term, the small producer would have the option to contract directly with the previous interstate purchaser from Phillips or with another interstate purchaser. In the event a new contract is made with an interstate purchaser, new facilities must be constructed by the purchaser to handle such gas. The consumer must pay not only the cost of the above-ceiling prices to the small producer but the cost of the new facilities as well. In the meantime, Phillips' existing facilities are idle or only partially utilized.

Should Phillips seek to maintain its gas supplies by entering into a new contract with the small producer at the same above-ceiling prices offered by the interstate purchaser, Phillips must divert such gas from the interstate to the intrastate market, since obviously, Phillips cannot purchase the gas at above-ceiling prices and resell it at ceiling prices. Phillips' diversion of such gas to the intrastate market would not constitute an unauthorized

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abandonment, since the abandonment, if technically such occurs, would be by the exempted small producer and no permission would be required. In any event, it would be clearly confiscatory to seek to require Phillips to continue to purchase the gas at a price higher than it was allowed to receive upon resale.

These considerations demonstrate the fallacy of the theories adopted in Opinion No. 468 that "abandonment" is an adequate substitute for above-ceiling prices in hardship cases. In *Permian*, the Commission asserted, "Even in situations where producers are able to show that they are entitled to relief from the obligation to continue to sell flowing gas at the appropriate area ceiling, in most cases it may be sufficient to permit them to abandon their unprofitable sales." (34 FPC at 226) The Supreme Court was persuaded to accept this platitude and even

to accept abandonment as the primary relief in such circumstances:

> "Indeed, the Commission has already acknowledged that only in 'exceptional situations' would the abandonment of unprofitable activities prove detrimental to consumers, and thus impermissible under § 7 (b)." (*Permian Basin Area Rate Cases*, 390 US 747, 773)

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In the light of the present needs of interstate pipeline companies to maintain all of their existing supplies, forced abandonment in lieu of above-ceiling prices to large producers can hardly be classed as service to the consumer.

3. <u>Statutory Authority For Total Exemption Is At Least Doubtful.</u>

Whether statutory authority exists for total exemption of small producers is a matter semmingly not considered by the Commission. The Commission is authorized to classify natural gas companies by size and to differentiate the degree of regulation among such classes. Authority to classify, however, does not inherently include authority to exempt. While the existence or lack of such authority might ordinarily be a matter of more concern to small producers than to large producers, in view of the discrimination against Phillips referred to above in the proposed regulations Phillips must and does hereby challenge the proposed regulations as exceeding the statutory authority of the Commission. We find no warrant in the Natural Gas Act or in the decisions construing the Act for such exemption.

*Conclusion*

As an effort to induce increased exploration for natural gas, exemption of small producers misses the mark.

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Solutions for gas supply problems are to be found in adequate prices applicable to all producers, not to small producers alone. It is folly to believe that allowing above-ceiling prices to small producers will thereby enable the Commission to induce or even force substantial sales by large producers at unrealistically low prices.

To reach the ends sought, the proposed regulations are unwise. In the manner in which they would be enforced, the proposed regulations are unlawful.

Respectfully submitted,

PHILLIPS PETROLEUM COMPANY

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August 25, 1970

Federal Power Commission
Washington, D. C. 20426

RE: NOTICE OF PROPOSED RULEMAKING EXEMPTION OF SMALL PRODUCERS DOCKET NO. 393

Gentlemen:

Pursuant to the Notice of Proposed Rulemaking, Docket No. R-393, entitled, "Exemption of Small Producers from Regulation" and your request for comments from all interested persons, I submit for your consideration the following views, comments and suggestions.

First, with reference to my own qualifications, this is to advise that I have practiced law in South Texas for approximately 34 years, during which time I have represented a substantial number of independent oil and gas producers and some majors and have been intimately familiar with the oil and gas industry. I am firmly convinced that the exemption of small producers from regulation under the Natural Gas Act will result in the discovery, production and dedication to interstate commerce of substantially more gas, will increase the quantity of gas available to the consumer and will have very little effect on the ultimate consumer price.

The Commission's Notice proposing an exemption of small producers from regulation under the Natural Gas Act, seems to

be based largely upon the *de minimis* aspects of the small producer in terms of the total volume of gas produced and sold annually by the gas industry. While this fact lends support to the relief of the small producer from price regulation since the dollar impact on the consumer in any event will be relatively small, I do not believe that this position presents the real importance of the small producer to both the gas industry and the consumer.

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Historically the small producer has been the pioneer or wildcatter. He has been the one who has been willing to risk his own capital to venture into new potential gas supply areas and to bear the risk and expense of finding new gas reserves. Additionally, the small producer has been in effect, the catalyst for assembling large segments of capital into joint ventures for exploration and development of gas reserves.

The small producer, with limited capital, and the necessity for a prompt return for himself and to satisfy his associates and investors, has had to be aggressive in the drilling of exploratory wells and in the development of discovered reserves. The large producer, on the other hand, has had almost unlimited capital and through the years, adopted a policy of purchasing large leaseholdings in likely areas or trend plays, holding the leases and paying delay rentals thereon, in many instances waiting for development in the area. If the exploratory efforts of the small producer proved fruitful, the large producer, who usually had holdings in the area, then moved in with its greater capital resources, and developed the newly discovered gas field, and in many instances, purchased the interest of the small producers, adding them to its already substantial reserves. But, the small producer has been the one who in so many instances has been responsible for the discovery of many substantial reserves presently owned by the large producers and committed to interstate commerce. Thus, although the small producer may be *de*

*minimis* in terms of the total amount of gas produced and sold annually, the great importance of the small producer lies in his gas finding function. The small amount of gas sold by the small producer in interstate commerce does not present a fair, nor an accurate picture as to the real importance of the small producer from the standpoint of discovery of gas reserves.

The advent of Commission producer regulation added a tremendous additional burden to the small producer, both in expense of compliance and legal expenses and in paper work. Because of the small producer's limited operations, the percentage of increase in cost to the small producer has been proportionately greater than to the large producer. Additionally, steadily rising costs of exploration and development, plus the reduction in the depletion allowance,

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have all tended to reduce the incentive of the small producer and his ability to attract capital to conduct exploratory operations. Many of the small producers have been forced to substantially curtail their exploratory operation and some have withdrawn from the oil and gas business entirely, all of which has caused a substantial loss in the exploration for and discovery of new reserves. Relief from the burdens imposed by Commission regulation should attract more capital to the oil and gas business and will induce more small producers to further their gas exploratory operations.

At a time of critical gas shortage, increased gas exploratory efforts are particularly important and, therefore, I believe should receive primary emphasis. Not only is the consumer not economically harmed by the exemption of the small producer from Commission regulation, but more importantly, the consumer will be benefited as a result of the increased gas exploration by the small producer.

The attempt by the Commission to regulate the small producer has proven to be an almost impossible task and has created confusion, chaos and inefficiency in the Commission's oepration. The exemption of the small producer would benefit the Commission in that the Commission's staff could devote its time to the relatively few large producers who are responsible for the production and sale of the major portion of the gas in interstate commerce. Thus, as a result of this exemption, the Commission would be in a much better position to more efficiently and properly perform its primary function of consumer protection.

The rising costs and the diminishing profits of the small producer, resulting in a large measure from Commission regulation, has caused a continuing decline in investment funds for gas exploration. As a result, the exploratory operations of the independent producer have of necessity been substantially curtailed. The exemption of the independent or small producer from Commission regulation would increase the flow of investment funds, would stimulate exploratory operations and result in the greater discovery of gas reserves.

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Because of the tremendous expense of compliance with Commission Regulations, the uncertainty as to the price which the producer will ultimately receive for his gas, plus the possibility of refund obligations, have caused the small producer not to dedicate its gas to interstate commerce, but on the contrary, to sell the gas in intrastate commerce. Attached hereto as Exhibit "A" is a statement of the experience of one group of small producers who sold their gas in interstate commerce and have regretted it ever since. This case illustrates why small producers who have had such experiences would probably never again dedicate gas to interstate commerce and bear the expense of Commission regulation and assume the risk of the ultimate price reduction and refund obligations. If, on the other hand, the

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small producer is exempted from Commission regulation, then the small producer would increase its exploratory efforts and dedicate more gas for interstate consumption.

The Commission suggests, in the Notice, that interested parties are invited to address themselves to the question of terminating present proceedings and relieving the small producers of any potential refund obligation therein.

Everything which has been said above about the importance of exempting the small producer from Commission regulation applies equally to the termination of present proceedings against the small producer and the release to the small producer of monies which he has earmarked for refund. Moreover, if the dollar impact upon the consumer is *de minimis* as a result of the small producer exemption for the future, then logically it would seem to be equally *de minimis* for amounts collected, subject to refund for the past. Due to the numerous imperfections in the refund procedure, there is no real assurance that the refunds, if ultimately required, will be "flowed through" to the ultimate consumer. Therefore, if the refunds are insisted upon, they will simply be a windfall to the distributors, to which the distributors are not really entitled. Because of the small amount of gas sold by the small producers in interstate commerce, even if the refunds of the small producers were flowed through to the ultimate consumer, it would not amount to over a few cents and would be of no real consequence. If these refund proceedings were terminated and the obligation of the small producers to make refunds were cancelled, it would make practically no effect on the price of gas to the ultimate consumer, but would result in placing the small producer in a position to use such monies for further exploration and discovery of additional reserves so badly needed.

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Freedom of Commission regulation would assure the small

producer of an adequate price for the gas freed of the expense and burden of Commission regulation and refund, and would thus put the small producer in a position to assume its traditional role of pioneer in exploratory operations. If the Commission desired, the refunds so released to the small producer could be earmarked for discovery and development of gas reserves. The termination of the refund proceedings and relieving the small producer from any potential refund obligation would stimulate the exploration for further gas reserves, and would result in the discovery and commitment of additional gas reserves to interstate commerce.

Respectfully submitted,

/s/ George P. Morrill

George P. Morrill
Morrill & Patton
Attorneys at Law

GPM:mbb

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## EXHIBIT "A"
## To Comments of George P. Morrill
## On Notice Relating to Exemption of
## Small Producers from FPC Regulations

In 1960, a Family Group of small producers, comprised of a widow, three children and six trusts, owned about 30% of the gas reserves under the Normanna Field in Bee County, Texas, in Railroad Commission District No. 2. The remaining 70% was owned by majors and several independents. Negotiations for the sale of such gas were had with almost every interestate and intrastate pipe line company in the business. Finally, about 30% of the gas was sold by one of the majors to Houston Pipe Line Company for intrastate consumption for a price commencing at the rate of 16¢ per mcf, with a 2¢ per mcf escalation during each of the three succeeding five year periods. Under the terms of this contract, this gas is presently selling for 20¢ per mcf, and on October 1970 will escalate to 22¢ per mcf. The Family Group of small producers (referred to as "FG") was offered and could have made the same intrastate sale to Houston Pipe Line Company. At the same time Natural Gas Pipeline Company of America had offered FG a gas sales contract commencing at 18½¢ per mcf. In a quandry as to what to do, FG engaged competent Washington attorneys, specializing in FPC matters.

By September of 1960 the Federal Power Commission had for six fruitless years been attempting to regulate the producer on the Cost of Service Approach and everything was in a state of chaos, turmoil and confusion. On September 28, 1960, FPC rejected the Cost of Service Approach and adopted the Area Price Approach for independent producer regulation and at the same time issued its Statement of General Policy No. 61-1. The Statement of General Policy No. 61-1 (herein referred to as "61-1") established a price, which was later referred to as

"Guideline Price", of 18¢ per mcf for gas in Railroad Commission District No. 2. The whole tenor of 61-1 convinced our Washington attorneys and practically everyone in the business, that if the gas was sold at a price not to exceed the maximum rate of 18¢ per mcf in Railroad Commission District No. 2, that such price would be acceptable to the FPC and no refunds would be required. At this time it was the policy of FPC that if a refund was to be required a certificate would be issued upon the condition of refund and if a certificate was issued without any condition requiring a refund, no refund would be required. Additionally, under the law as it existed

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at such time, decided in the case of *Sunray - Midcontinent Oil Company vs. FPC, 270 Fed. 2d. 404.* FPC had no authority to direct a refund on an unconditioned Temporary Certificate. In addition, members of the FPC in various talks before interstate groups, had assured the producers that any price not exceeding the maximum prices provided in 61-1, would be accepted by FPC and would not be reduced and no refunds would be required. Acting in reliance upon 61-1, the representations of FPC, the existing case law and the belief in the inherent fairness of FPC, FG rejected the intrastate sale to Houston Pipe Line Company and entered into the contract with Natural Gas Pipeline Company of America. FG then made application for Certificate of Public Convenience and Necessity and received a Temporary Certificate, which was *issued without any condition requiring a refund.* In the acceptance of such certificate, out of an abundance of precaution, FG inserted the wording, "without obligation to refund". This acceptance was accepted by FPC and on March, 1961, deliveries were commenced. Had FG had any intimation of the trials, troubles and expenses to which they would be subjected by reason of this interstate sale, and of the complete change of position which FPC would later make in its policy toward reduction of price and in requiring refunds on unconditioned certificates, FG would never have made this sale

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in interstate commerce.

Thereafter, the distributors contested the 18¢ price and after an extended Examiner's Hearing in which a large number of other cases were consolidated, the price was reduced to 16¢ per mcf. The refund question was severed in this hearing and held in abeyance. The Examiner's Hearing was appealed and sustained by the FPC and thence upon consolidation with a large number of additional cases, was heard before the Circuit Court of Appeals and then by Consolidation with a still larger number of cases, was heard in the Supreme Court. In the Supreme Court so many additional cases had been consolidated that any specific or peculiar problems relating to any individual producer were largely lost in the shuffle. The distributors, all through the proceedings, like a pack of hungry wolves, contended for a price lower than 16¢ per mcf and strongly urged that refunds be required even on unconditioned certificates. We submit that the distributors were not as interested in protecting the interests of the consumer as they were in getting this "windfall" of refunds which they hoped would ultimately find a safe resting place in their own bank deposits. Before the Supreme Court the staff of the Federal Power Commission completely reversed its position and advocated the requirement of refunds on unconditioned certificates. One of the justices asked the attorney for the Staff, in his argument, if FPC had not assured the producers that there would be no refunds on unconditioned temporary certificates, to which the attorney replied that such was the case, but that FPC could

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not be bound by representations or estoppel. It came as quite a shock that FPC would make representations inducing producers to dedicate their gas to interstate commerce and then repudiate such representations. They felt that they had been entrapped. The Staff was advised privately that this type of conduct might result in getting refunds, but it would assuredly result in a loss

of confidence in FPC which in turn would prevent the dedication of reserves of gas to interstate commerce, and that perhaps sometime down the line these reserves might be badly needed. The Supreme Court, pursuant to the request of FPC, granted refunds on unconditioned Temporary Certificates, and pursuant thereto, FPC required refunds from both large and small producers, together with interest.

Had FG not relied upon the representations of FPC, FG would have sold its gas to Houston Pipe Line Company in an intrastate sale, would have been saved all of the tremendous time and expense involved in FPC Regulation, would have been saved tremendous legal expense, would not have been required to make any refunds, and would presently be receiving 20¢ per mcf, and beginning October 1970, 22¢ per mcf instead of 16¢ per mcf, which they are now receiving.

At great sacrifice to themselves, FG deposited the required refunds in escrow, and since this costly experience, have done very little exploration and any gas reserves found have been sold to intrastate commerce. We realize that the personnel of the FPC has changed since the events outlined above, but FG having had their fingers burned so badly, on this occasion, will probably never dedicate another cubic foot of gas to interstate commerce so long as they are under FPC regulation. The refunds so held in escrow at this time will have practically no effect upon the price of gas to the ultimate consumer. As a matter of fact, because of the many defects in the refund procedure, it is highly unlikely that these monies would ever be "flowed through" to the consumer, but will come to rest in the pockets of the distributor, as the windfall to which the distributor is not entitled and which will serve no useful purpose.

There is a possibility of deeper gas reserves under the Normanna Field. These reserves are not committed to interstate commerce and so long as small producers are subject to FPC regulations there is absolute certainty that if such additional gas

reserves are found and developed, that they will not be dedicated to interstate commerce.

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Over the years FG have done a tremendous amount of wildcat, exploratory drilling and have been successful in discovering considerable gas production. If they are exempted from FPC Regulation it will stimulate their development operations, will no doubt result in the discovery of additional gas reserves, and with the assurance of a firm price and no refunds, will probably result in the dedication of such gas to interstate commerce. But, unless they are exempted from FPC regulation, with the experience which they have had, their exploration, if successful, will go to intrastate commerce. Accordingly, we strongly recommend the exemption of small producers from FPC regulation as proposed in the Notice of Proposed Rulemaking, Docket No. 393, and the release to the small producer of any refunds required, or in escrow in any pending proceedings.

/s/ George P. Morrill

George P. Morrill

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UNITED STATES OF AMERICA

BEFORE THE

FEDERAL POWER COMMISSION

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| In the Matter of: | ) | |
| | ) | |
| Exemption of Small Producers | ) | Docket No. R-393 |
| From Regulation | ) | |

VIEWS AND COMMENTS

Come now HUNT OIL COMPANY, H. L. HUNT, HASSIE HUNT TRUST, CAROLINE HUNT SANDS, LAMAR HUNT, W. H. HUNT, N. B. HUNT, SECURE TRUSTS, A. G. HILL, HIDALGO GAS PRODUCTION CORPORATION, C. M. LANGTON, TRUSTEE, ALINDA HUNT HILL TRUST, HUNT PETROLEUM CORPORATION, HUNT INDUSTRIES, W. H. HUNT TRUST ESTATE, N. B. HUNT TRUST ESTATE, LAMAR HUNT TRUST ESTATE, H. L. HUNT, JR. TRUST ESTATE, CAROLINE HUNT TRUST ESTATE, LYDA HUNT-CAROLINE TRUSTS, LYDA HUNT-BUNKER TRUSTS, LYDA HUNT-LAMAR TRUSTS, LYDA HUNT-HERBERT TRUSTS, LYDA HUNT-MARGARET TRUSTS and PLACID OIL COMPANY, hereinafter jointly referred to as "Hunt, *et al.*" and submit, in response to the Notice of Proposed Rulemaking issued by the Commission on July 23, 1970, their views and comments relative to rules proposed to be promulgated in the captioned proceeding.

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For the reasons hereinafter set forth Hunt, *et al.* supports the Commission's proposed exemption of small producers from

rate regulation as a step in the right direction but offers certain suggestions for improvement of the proposal:

In support hereof, Hunt, *et al.* would show the following:

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Small producers are, and have long been, of vital importance to the nation's natural gas producing industry. Although it is said that they account for only ten percent of all jurisdictional natural gas sales[1] their production cannot be considered of little importance on an area basis[2]. Most important is the small producers' contribution in exploring for new gas supplies wherein they account for approximately 80 percent of all exploratory well drilled.[3]

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In their exploratory efforts they frequently drill prospects deemed too risky by the larger producers when viewed in the context of potential reserves to be discovered. Their drilling efforts often prove or disprove the presence of gas bearing structures, and the information gained is useful to all producers, large and small, in their search for new gas supplies. And yet, it is upon the small producer that the burden of regulation has weighed most heavily. Under the Commission's present cost based rate making system only the costs of the largest producers

[1] Response of Federal Power Commission Staff; Initial Rates for Future Sales of Natural Gas for All Areas; Docket No. R-389A (Page 24)

[2] Opinion No. 468, p. 12; Area Rate Proceeding, Docket Nos. AR61-1, *et al.*

[3] The record of the Southern Louisiana Area Rate Proceeding (Docket No. AR61-2) shows that small producers drilled 78.1% of all wells drilled in 1960 (T. 23,923-8) of which 31% were exploratory wells. Of the remaining wells drilled only 17% were exploratory wells. (See also Exhibit 181.)

are considered while small producer costs are ignored. This procedure of basing rates upon large producer costs is especially inappropriate for small producers since their costs are uniformly higher than those of larger producers.[4] These higher costs are due to their unique methods of operations founded upon a higher percentage of exploratory drilling, always expensive and extremely risky, and smaller lease holdings which necessarily support smaller reserves when drilling is successful. Full

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participation in area rate making proceedings is never feasible for small producers, and minimal compliance with the Commission's certificate and rate change procedures in disporportionally burdensome. It is known that many of the smaller producers are not receiving the rates for their gas sales to which they are entitled by contract simply because they are not sufficiently familiar with the Commission's procedures to know that they must file for higher rates. For each of these reasons Hunt, *et al.* is of the opinion that the exemption of small producers is warranted and supports the Commission's proposal.

While supporting the Commission's proposal in general, certain comments are hereinafter made which should be given serious consideration prior to the adoption of the proposed rules.

## II

In its commentary on the proposed rules the Commission states:

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[4]See Exhibit 23—Area Rate Proceedings (Southern Louisiana) Docket No. AR61-2. See Exhibits 68-J and 69-J Area Rate Proceedings (Hugoton-Anadarko and Texas Gulf Coast) Docket Nos. AR64-1 and AR64-2.

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> "The exemption for small producers proposed here would include, *inter alia*, jurisdictional sales made by a small producer to a large producer. However, the resale of such gas by the large producer would remain subject to our jurisdiction." (page 3)

It is not uncommon for one producer to sell gas to a second producer who, after performing a transporta-

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tion, compression or processing service, resells the gas to an interstate pipeline. In this arrangement the second producer contracts to seel the gas at a rate slightly higher than he pays the first producer for the gas. This price spread compensates the second producer for the services he performs for the benefit of the first producer. Under this fact situation, if the first producer is established as a "small producer" and thus exempted from rate regulation, he can receive the full contract rate for his gas sold to the second producer. If however, the second producer does not qualify as a small producer, his resale of the gas purchased would be subjected to regulation and the possibility of being prevented from realizing his contractually supported rate. Should he not be permitted to collect and retain his contract rate, the negotiated contract price spread would be lost and the profitability of the project impaired. In effect these circumstances would be to require the second producer, the large producer, to fund the small producer's exemption. This would be patently unfair and probably unlawful. It appears that there are two possible solutions to this problem. They are: (1) deny the small producer's exemption or (2)

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permit the second producer to collect his resale rate without

refund obligation insofar as the resold gas originates from small producers. Hunt, *et al.* favors solution (2). In no event should the second producer be restrained, by rate change moratorium or otherwise, from *collecting* his full contract rate.

III

Proposed Section 157.40 defines a "small producer" as one "who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of 'affiliated producers' are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year." Hunt, *et al.* submits that the line of demarcation between small producers and large producers was arbitrarily established by the Presiding Examiner in his Initial Decision in the Permian Basin Proceeding[5] and subsequently has been arbitrarily adopted by the Commission.[6] Hunt, *et al.* does not object to the use of the 10 million Mcf dividing point on an interim basis but urges the Commission to undertake imme-

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diately to determine the proper dividing point between the two producer classifications. There are significant differences between small producers and the larger producers. These differences should be defined and appraised before a permanent dividing point is established. For example, Hunt, *et al.* sponsored studies have shown that the larger the size of the producer in terms of gas volumes sold, the lower is its costs.[7]

[5]34 FPC 306 at 361–termed "the practical dividing line."

[6]34 FPC 159 at 235–Permian Basin Decision 40 FPC 530 at 612–Southern Louisiana Decision

[7]See Exhibit 243 (Excluded) accepted as Offer of Proof; Area Rate Proceeding (Southern Louisiana Area) Docket No. AR61-2. See also exhibits described in footnote 4, *supra.*

Accordingly, cost differences should be a factor for consideration. Smaller producers can neither acquire and hold large lease blocks as can larger producers nor can they drill wells in sufficient numbers to take advantage of the averages relative to successful exploratory completions. They always have less financial depth than do large producers and must endure greater financial risks. Often they have less bargaining power with prospective purchasers of their gas and obtain less favorable terms due principally to the fact that they usually develop smaller gas reserve packages. All of these factors should be considered prior to establishing permanently the dividing point. It is the

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considered opinion of Hunt, *et al.* that once completed such study would show that the proposed dividing point of 10 million Mcf annually is much too low and not supportable by presently available facts. It is believed that an adjustment upward to 25 million Mcf annually would be found to be more reasonable and more easily supported by existing facts.

IV

At pages 3 and 4 of the Notice of Proposed Rulemaking the Commission stated that it had not "proposed any disposition of increased rates collected subject to refund in Section 4(e) cases or initial rates collected under temporary certificates issued pursuant to Section 7 by small producers for the period prior to the effective date of the exemption." It further stated that the proceedings to which it was referring were those where the Commission had yet taken no action and none was pending as a result of an examiner's decision. Comments were invited on this point.

It is the view of Hunt, *et al.* that small producers should be relieved of all refund obligations at the time they are granted exemptions. This view is consistent with the other positions taken by Hunt, *et al.* herein and consistent with the Commission's recognition

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of the many differences between large and small producers which support more favorable treatment of the small producers. If exemption, and the right to collect contract rates as the result of that exemption, is determined to be justified for the future based upon conditions presently existing and known to exist in the past it would seem appropriate for the Commission to apply the rationale supporting that exemption to existing rates of small producers now burdened with a possible refund obligation and remove the refund conditions. This view is offered, however, only upon the premise that under no circumstance should a large producer be required to fund the small producer price advantage as discussed in Section II hereof.

V

Correspondence with regard to the foregoing views and comments may be addressed to:

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Hunt Oil Company, *et al.*
1401 Elm Street
Dallas, Texas 75202

Attention: Mr. Robert W. Henderson

and

Placid Oil Company
2500 First National Bank Bldg.
Dallas, Texas 75202

Attention: Mr. Paul W. Hicks

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WHEREFORE, Hunt, *et al.* respectfully requests that the Commission give studied consideration to the views and comments expressed herein and grant the proposed exemption of small producers in accordance therewith.

Respectfully submitted,

/s/ Donald K. Young
DONALD K. YOUNG
ATTORNEY FOR
HUNT, *ET. AL.*

September 4, 1970

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[COMMENTS OF JAMES M. FORGOTSON, SR.]

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## QUESTION PRESENTED

Whether [the] decision in the case of *Phillips Petroleum Co. v. State of Wisconsin,*[2] applying the provisions of the Natural Gas Act[3] to independent producers of unprocessed unassociated and casing-head gas, should be reversed, because in light of later actual experience and economic and technological changes such application now constitutes such invidious and arbitrary discrimination against said independent producers that the application violates their guarantees of equal protection of the law.

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## STATUTES INVOLVED

Section 1 (b) of the Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. § 717 (b) is involved and is reproduced * * * in our Appendix.

## CONSTITUTIONAL PROVISIONS INVOLVED

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[2]347 U.S. 672 (1954)

[3]15 U.S.C. 717 (b), *et seq.*

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Constitution of the United States, Amendment V:

"No person shall . . . be deprived of life, liberty, or property, without due process of law . . ."

Constitution of the United States, Amendment XIV, Section 1:

"No state shall make or enforce any law which shall . . . nor deny to any person within its jurisdiction the equal protection of the laws."

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*The Court of Appeals Opinions.* Since this petition attacks the very jurisdiction of the Federal Power Commission over independent producers of unprocessed unassociated or casinghead gas on constitutional grounds, the specific rulings * * * are not relevant. However, as set forth fully in the next portion of the petition, the continued application of a public utility regulatory process to independent gas producers by the Federal Power Commission * * * along with the misclassification of utility-distributors as consumers or consumer interests * * * significantly affect the importance of [this comment].

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REASONS * * *

1. Importance of this case to all segments of the natural gas industry and all classes of consumers cannot be overstated. A shortage of natural gas already exists. That shortage is directly involved in this case * * *.

The gas supply situation is greatly affected by the rates prescribed by the Federal Power Commission in this case and the regulatory process imposed on sales for resale in interstate commerce by independent producers of unprocessed unassociated or casing-head gas by this Court's decision in *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954). In fact the supply situation is more affected by the last mentioned item than by anything else. Thus, reconsideration and reversal of the regulatory process instituted by this Court in *Phillips Petroleum Co.* v. *State of Wisconsin*, *supra*, are indicated for the important reasons which are set out below.

2. Even former decisions of the United States Supreme Court sustaining the constitutionality of a specific state police regulation do not preclude bringing subsequent suits to test their validity in light of later actual experience, because regulations, valid when made, may become arbitrary and confiscatory in operation by reasons of later events. See *Abie State Bank* v. *Weaver*, 282 U.S. 765 (1931).

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* * * [T]he issue itself goes to the very jurisdiction of the Federal Power Commission over the subject matter of the case. * * *

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3. The application of FPC price ceilings on sales for resale in interstate commerce of unprocessed unassociated and casing-head gas produced by independent producers is an unconstitutional discrimination against the independent producer. In light of current and evolving technology and economics in the fuel and energy industry, the application of the provisions of the Natural Gas Act of 1938 to any of the sales of unprocessed unassociated and casing-head gas by independent producers constitutes unconstitutional invidious discrimination. This discrimination is against independent producers in favor of distributor-utilities both of whom are *suppliers and not consumers* in the natural gas *supply industry*, and against these same producers in favor of producers of fuels and energy sources other than unprocessed unassociated and casing-head gas, i.e., oil, liquid petroleum condensate, liquid petroleum gas, coal, and lignite producers, who are all part of the nation's energy industry. Because such discrimination is invidious, application of the Act to independent gas producers would be a violation of constitutional guarantees of Equal Protection of the Law, and thereby be violations of the Fifth Amendment of the Constitution. Equal Protection of the Law guarantees are provided against discriminatory acts of the Federal Government through inclusion of equal protection guarantees within the Due Process Clause of the Fifth Amendment. See *Brown* v. *Board of Education of Topeka*, 347 U.S. 483 (1954) and 349 U.S. 294 at 298 (1955), which by implication applied equal protection clause provisions

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to end racially segregated schools in the District of Columbia, which are governed *by federal, not state law*. The Court stated that all provisions of *federal*, state or local law requiring or permitting racial discrimination in public schools must yield. 349 U.S. 294 at 298.

**4. Legal creation of closed classes through economic regulatory programs which advance the economic interests of the closed classes constitutes a violation of the Equal Protection of the Law guarantees of the Federal Constitution.**

The most recent United States Supreme Court decision applying constitutional Equal Protection of the Law guarantees (of the Fourteenth Amendment) to invalidate economic regulation was the case of *Morey* v. *Doud*, 354 U.S. 457 (1957). Our contention is that application of FPC price ceilings to wellhead sales of unprocessed unassociated and casing-head gas by independent producers comes within the purview of the rule for applying equal protection guarantees to invalidate economic regulations announced in *Morey* v. *Doud, supra.* This is in spite of (1) the now substantially undisputed power of Congress to pass *nondiscriminatory* economic regulatory legislation under the Commerce Clause of Article I of the Constitution (*N.L.R.B.* v. *Jones and Laughlin Steel Corp.*, 301 U.S. 1 (1937); and *Wickard* v. *Filburn*, 317 U.S. 111 (1942); and (2) the equally undisputed decisions that such regulation either by the States or the Federal Government does not constitute a taking without due process of law. (*Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575 (1942); *Nebbia* v. *New York* 291 U.S. 502 (1934)).

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In *Morey* v. *Doud, supra,* a three-judge District Court was upheld by the United States Supreme Court in enjoining enforcement of the Illinois Community Currency Exchange Act of 1943 because said Act violated the

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Equal Protection Provisions of the Fourteenth Amendment.

The Act in question provided a comprehensive system for licensing and regulation of community for-fee check cashing services and issuers of money orders and made operation of an unlicensed establishment a crime. In order to obtain a license

these establishments were required to pay both licensing and investigative fees, furnish information to the Illinois State Auditors Office, maintain specified amounts of cash on hand and possess surety bonds in specified amounts. In addition, each exchange had to be an entity financed and conducted as a separate business entity. Finally, a license could not be issued unless the State Auditor determined that its issuance would promote a convenience and advantage to the community. The American Express Company and its money orders were explicitly exempted from the provisions of the Act.

In sustaining the lower court by a 6-3 vote, the majority of the United States Supreme Court made the following points clear with respect to application of Equal Protection Clause provisions to economic regulatory legislation:

a. The prohibition of the Equal Protection Clause goes no further than *invidious* discriminations.

b. The Equal Protection Clause does not take from the States the power to classify in the adoption of policy laws.

c. The Clause permits the exercise of a wide scope of discretion in classification and prohibits only those that are purely arbitrary.

d. The practical result of some inequality in application of the regulation is not sufficient to invalidate the regulation.

e. The Complainant must carry the burden of showing that the law in question does not rest upon any reasonable basis, but is essentially arbitrary.

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f. Provisions to be valid *cannot single out any company or group of companies,* irrespective of their unquestioned reputations, and create a closed class with the accompanying economic advantages to such company or group.

The creation of a *closed class with the accompanying clear economic advantage given to that class* was the fatal defect in the Illinois Act and will be the basis of any further application of the Equal Protection guarantees to invalidate economic regulation, state or federal. *Morey* v. *Doud, supra,* has never been overruled by the United States Supreme Court.

This question subsequently has come before State Supreme Courts, none of which have departed generally from the basic 1957 rule, although most have failed to find *creation of a closed class in the facts presented* and thereby have not invalidated the legislation. See, *e.g., Donohue* v. *O'Connell's, Inc.*, 164 N.E. 2d 52, 18 Ill.2d 432 (1960)

Consequently, our theory is that the application of the Natural Gas Act of 1938 to gas sales of unprocessed unassociated or casing-head gas by independent producers creates *closed* classes or groups which are given accompanying clearcut economic advantages, making this application constitute *invidious* economic discrimination or class legislation.

5. Application of the Natural Gas Act and Federal Power Commission price ceilings to independent producers creates a closed class, the retail distributors in the natural gas supply industry, and invidiously discriminates against the independent producers in favor of the distributor-utilities.

The Court in the case below has classified the parties to natural gas regulatory litigation as producers, consumers and the Commission (meaning the Federal Power Commission). See Continental Appendix A, pp. 1-2.

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It has classified producers and pipeline companies as producers, utility-distributors as consumers or consumer interests, and the Commission as the Commission. No argument can be had with classifying the Commission as the Commission. From that point

onward, however, the court below has been in error. In reality the three classes are: Suppliers (which includes *producers, transporters and distributors);* Regulators, which balance the interests of consumers and suppliers in the interests of social and economic justice (which includes at least the Federal Power Commission and state public utility or service commission and which *should* include the conservation commissions of the states); and Consumers, e.g., housewives or industrial enterprises using gas as process fuel or heat source. This error has resulted in *identifying* (as was made abundantly clear in the case below) producers and distributors as members of *different* classes, thereby permitting vastly *unequal and inappropriate* regulatory treatment of the independent producers.

It is our contention that this error, which was so clearly illustrated in the case below, has resulted in placing a discriminatory burden on one of the members of the *Supplier* group in order to protect another member of that *same group* from that member's own frequent lack of aggressiveness and continu.' operations under many, often anachronistic state regulatory laws on the grounds that this is protecting the consumer interest. The latter interest actually is a far different species from the *interest* of the retail public utility-distributor who is frequently an entrepreneur operating at a profit with substantial earnings.

To do this legislatively goes beyond mere lack of wisdom, providence and harmony with a particular school of thought. See *Williamson* v. *Lee Optical Co. of Oklahoma*, 348 U.S. 483 (1955). It constitutes legislation which in light of current conditions is arbitrary and in-

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vidiously discriminatory. It has created a closed class of entrepreneurs within the supplier group (the distributors who already have a regulated natural monopoly), who are subject to risks in no way comparable to those of the independent producer of

unprocessed unassociated or casing-head gas. The distributors earn a guaranteed rate of return for their security holders and have a competitive advantage against other energy sources, because of their being able to buy their raw material (either unassociated or casing-head gas in an untreated, unprocessed state) at a controlled maximum price, free from market forces.

What has occured is that one unit (the independent producers) in the supplier group is in fact being regulated as a public utility, which in fact it is not. Such regulation has been evolving for nearly 17 years, to protect the interests of the utility-distributors who hold a natural monopoly and whose interests have been judicially mis-identified with the consumers.

The results of this error have been extremely serious and clearly not in the best interests of the consumers. This error has contributed to a fuel shortage, particularly a shortage of natural gas, with a possibility of natural gas rationing among consumers and importation of liquefied natural gas from foreign countries at prices at least two or three times higher than the current or contemplated price ceilings imposed on U.S. producers. Although this only goes to the wisdom rather than the constitutionality of the application of the Natural Gas Act and governmentally imposed price ceilings on independent producers, it puts the issue into clearer perspective.

In dealing with the constitutional question of equal protection, it is our contention that the Congress, by imposing a form of public utility regulation on natural gas producers, which the United States Supreme Court *later*

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clearly stated are *not* public utilities,[6] has not only misclassified producers, but also has put them under a regulatory program

[6] See *In re Permain Basin Area Rate Cases*, 390 U.S. 747 (1968).

which invidiously advances the conomic interests of the distributor by trying to assure him a supply of raw material at lower than free market costs. Consequently, the distributors can make a profit and expand their sales volume while (1) failing to take significant aggressive steps, on a sufficiently realistic scale to work toward adequate supplies at competitive prices, and (2) operating under anachronistic state regulatory laws, which they make no effort to change.

To meet the test of equal protection all members of the group should be treated alike to the greatest extent possible. The test does not require either comprehensiveness of regulation or absolute or mathematical equality of treatment. Neither does it require dealing with all facets of the problem at the same time, but allows legislative discretion to "attack some evils before attacking others." Nevertheless, equal protection does not or should not *permit* one member of a group to be regulated in order to advance the economic interest of another group in the same class without clear justification. In the current situation, one member of the supplier group is advanced at the expense of *another* and the consumer as well.

It might be argued that no discriminatory treatment exists since both independent producers and distributors are public utilities. There is no question about the propriety of treating distributors with regulated natural monopolies as public utilities and imposing some public utility regulatory procedures upon them. That public utility regulatory procedures for independent producers is not appropriate was made clear by Mr. Justice Harlan in the *Permian Basin Area Rate Cases, supra,* and by Judge Thornberry in the case below.

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The issue then becomes whether the inevitable result of any governmental price ceilings imposed upon independent producers of unprocessed unassociated or casing-head gas must *perforce,* regardless of freedom of the Commission to experiment,

be public utility treatment and be inappropriate. Our contention is that the answer to this question is yes and that the treatment is so inappropriate as to be invidiously discriminatory. This is because if a group which has no characteristic of a public utility with a natural monopoly is nevertheless regulated as one with the end result of advancing the economic interests of another unit in the same group (the supplier group), then there is invidious discrimination.

The courts in the abstract thus far have answered the above question as *no* by saying that the Commission *need abide by no fixed formula and can pragmatically adapt policies and procedures to meet changing conditions.* Our contention is *that as a practical matter the answer will inevitably be yes, because this is all that a regulatory agency like the Federal Power Commission can do.* It can develop formulas *ad infinitum,* but they all have been and *perforce* will be based on allowing some "fair" rate of return on capital and operating costs with or without added nonmarket incentives to stimulate exploration and development of reserves.

The Federal Power Commission's actual performance up to the present substantiates our conclusion.

In all of the gas rate cases the only real controversies involve what should be allowed as capital costs, what are operating costs, what should be allowed as a fair return on an investment (including such questions as whether expenditures for dry holes or gas of less than pipeline quality constitute costs or risks) and should incentives for exploration be allowed, and if so how much. These are all classical public utility regulation questions, whether they be based on (1) producer by producer or well by well

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costs, (2) area-wide average costs, or (3) nation-wide costs with

special consideration given to exploration and development incentives to encourage the finding of new gas. It is also public utility regulation whether historic costs or projected costs are used as the basis for calculating a "fair" return. In spite of all protestations to the contrary, this is all the Commission or any commission can ever do when it regulates by imposing price ceilings on independent producers.

The Fifth Circuit * * * said that the Federal Power Commission has the power to set prices on the basis of costs and that market variables do not necessarily have to influence the calculation, but that the Commission must examine even a cost computed rate against the ultimate statutory purposes it is supposed to be carrying out. * * * The Court in its dictum went on to say that it advocated a mixture of market (supply and demand factors) and cost computed rates to regulate industry performance.

It prescribed the following steps to be taken by the Federal Power Commission in arriving at the price ceilings:

(1) estimation of needs for consumer service—demands for gas;

(2) use of the above estimation to fix the level of service aimed at, explaining how the level of service aimed at is related to estimated demand in case demand is not to be fully satisfied by the regulatory program; and

(3) making findings as specifically as possible as to how the rate it has set will affect the industry's tendency to meet the level of service, i.e., what supply rate will be brought forth, while at the same time preventing the occurrence of excessive prices.

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This is fine theory. However, econometrics is an inexact science, at best, and the ultimate practical result will always be a cost-computed ceiling with some *lagniappe*, supported by some econometric theorizing and forecasting for its justification, thrown in. Whether this *lagniappe* added to standard public utility cost-computed prices is adequate, as a practical matter, to maintain a healthy industry is almost purely a matter of guesswork. This will be the case if anyone will realistically look at what can be done with the science of econometrics *with currently available data and data collection methods and facilities, with even the most advanced estimation techniques.* The result will be actually some variation of standard public utility regulation for a group with none of the characteristics of a public utility.

Consequently, whether the Federal Power Commission has evolved a potentially workable regulatory procedure after nearly seventeen years or not, is really not material. Whatever they develop will be a public utility regulatory procedure which is a *prima facie* wrong approach for regulation of independent producers of unprocessed unassociated or casing-head gas. When this is coupled with the use of the regulatory process to advance the economic interests of another supplier unit, the retail distributor, who has a guaranteed market and the advantages of a natural but regulated monopoly, it constitutes invidious discrimination and violates the guarantees of equal protection of the law *unless some clear-cut justification for its exists.*

This leads then to the question of where or what is the justification?

The major apparent justification is that the "end result" brings lower or more slowly increasing prices of energy to the consumer. Obviously, such an "end result" could be accomplished by better management of the utility-distributors, better

stoves or furnaces, better state regulation of utility-distributors (including more

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modern state regulatory statutes), improved capitalization of utility-distributors, mergers of some distributors to bring about more capital and a better inflow of management and technology, etc.; consequently this justification is arbitrary.

If achieving an end result by a means that results in invidious discrimination against one unit of the supplier group (the producer) to advance the economy of another supplier (the distributor) rather than a more equitable and less discriminatory alternative means is used, then the discriminatory means should be held to violate the guarantees of equal protection of the law and be declared invalid.

That protection of economic interests by the Due Process Clauses of the Fifth and Fourteenth Amendments should not be abandoned has been recently restated with great clarity. See Streuve, The Less Restrictive Alternative Principle and Economic Due Process, 80 Harv. L. Rev. 1463 (1967). The author delineates the less restrictive principle and advocates a return to its use by the Supreme Court as an independent ground for invalidating over-broad regulations to permit a better balancing of interests between private parties and the government. The principle is that an economic regulation violates due process if the government has a less restrictive alternative. In dealing with regulations of personal freedom not involving either freedom of expression or civil rights, the United States Supreme Court also indicated that a test of the less restrictive and burdensome alternative on those regulated to accomplish the legislative end sought was required by the Constitution. See *Griswold* v. *Connecticut*, 381 U.S. 479 (1965).

The only other possible justification would be the monopolistic nature of the unprocessed unassociated and casing-head gas sales market at the wellhead. This is discussed more fully later, and it can be clearly stated

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that no monopolistic situation exists. This fact was further emphasized by Mr. Justice Harlan speaking for the majority in the *Permian Basin Area Rate Cases* when he characterized producers as "intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded search," 390 U.S. 747 at 757 (1968).

That the distributor utilities are a natural monopoly and subject to state regulation on a cost derived basis and that long–line interstate processed natural gas pipelines frequently integrated with their own production facilities might have shown monopolistic tendencies in 1938 and afterwards at the state of both technology and the economy then, and needed regulation because they were immune from state regulation, does not justify imposition of public utility regulation on non-integrated independent producers' sales of unprocessed unassociated and casing-head gas at the wellhead *today* to curb a monopolistic situation.

6. By singling out producers of unprocessed unassociated or casing-head gas for governmental price ceilings, the Federal Government has given a clearcut economic advantage to producers of competing fuels and created a clearcut closed class, i.e., producers of other fuels, whose economic interests are advanced by the regulation without clear justification.

Unprocessed unassociated or casing-head gas is a fuel or energy yielding commodity just like coal, lignite, oil, liquid petroleum condensates, liquid petroleum gases and uranium which

compete with it in the national energy market. Consequently, by singling out this one unprocessed commodity for governmental price ceilings on independent producers, a closed but large economic class is created with concomitant economic advantages. Creation of such a class constitutes invidious discrimination and violates equal protection guarantees unless the unique

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treatment is justified. Consequently, the issue is, is there any unique characteristic of unprocessed unassociated or casing-head gas or independent producers thereof to justify this classification.

**a. Transmission or transportation.**

In this country because of advances in technology, particularly that related to transmission of fuels, coal and lignite slurries as well as natural gas, oil, liquefied petroleum condensates and liquefied natural gases can and are now being transported by pipelines in interstate commerce, either for use or resale at their remote destination. Coal, lignite, oil, liquid petroleum condensates, liquid petroleum gases, and heavier so-called bottle gases (e.g., butane and propane) are also sold either at the well-head, mine shaft, excavation pit, refinery, or gas processing plant to pipelines for interstate transmission and subsequent resale or sold directly to customers, not for resale, who then use pipeline facilities to transmit the product or commodity to locations in distant states for use as fuels or energy sources. Furthermore, natural gas (methane) itself can be liquefied and shipped via railroad tank car, truck, barge or ocean-going tanker rather than by a pipeline to interstate or foreign destinations either for resale or direct use, just as other hydrocarbon or fossil fuels and the nuclear fuel uranium can be shipped. As a result there is nothing unique about unprocessed unassociated or casing-head gas or its producer's in these characteristics which separates

them from other fossil fuels or nuclear fuels. The independent producers simply supply a commodity to provide energy.

b. Scarcity and wasting asset nature of natural gas.

It can be assumed that natural gas is a wasting asset, in actual or potential short supply in the United States. So are coal, lignite, oil, liquid petroleum condensate, liquid petroleum gases and uranium. Consequently, unproc-

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essed unassociated or casing-head gas and its producers have no unique characteristics in this regard.

c. Influence of price of commodity at wellhead on end price of service or consumer use.

It can also be assumed that the price of unprocessed unassociated or casing-head gas at the wellhead influences the retail price of fuel or energy to both domestic and industrial consumers. So do the prices of all other fuels or energy producing commodities such as coal, lignite, oil, liquid petroleum condensates, and uranium. Similarly, it must be assumed that the price of the actual service, i.e., end product of commodity use (e.g., cooking, winter heating, electrical generation, industrial process heating), is also highly determined by the price of such items as household gas ranges, gas furnaces, boilers, steam turbines and nuclear reactor components. Consequently, unprocessed unassociated or casing-head gas or independent producers thereof, are not unique in that respect.

d. Uniqueness because of characteristics of retail distributors of the commodity.

It can also be assumed that unprocessed unassociated or casing-head gas for both domestic and industrial use is actually

usually distributed (after processing and shipment from the well) to ultimate consumers (domestic and industrial) by natural monopoly public utility distributor companies who are closely regulated as to prices and practices by state and in some cases county or municipal statutes, ordinances and regulations, whether the gas goes to the consumers as gas or is used as boiler fuel to generate electricity. So are oil, coal, lignite, liquid petroleum condensates and nuclear fuels when they are used to generate electricity or produce centrally generated piped-in steam for heating or industrial or other purposes. Only when gas goes as gas for actual burning by the consumer does it differ from oil,

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coal, lignite, liquid petroleum condensates or uranium in being distributed by a legally regulated natural monopoly—i.e., a public utility company. Even then, it is sold by the regulated utility company *in competition* with electricity (such as for domestic heating, cooking or cooling), which itself is in many cases distributed by the *identical* utility company that distributes the gas for similar purposes.

**e. Natural gas is the ideal fuel and consequently production by independent producers requires unique treatment.**

It must also be assumed that methane-natural gas (unassociated or casing-head gas after processing to remove such things as water, sulfur, carbon dioxide, helium, associated liquid hydrocarbons and heavier gaseous constituents such as ethane, propane and butane) is a very excellent fuel in that it has a high BTU value per unit volume (averaging about 1,000 BTU/cubic foot), and burns without fly ash or sulfur oxides, and without many products of incomplete combustion such as hydrocarbon radicals and carbon monoxide. This makes it a virtual nonpolluter as far as air pollution problems go. However, nuclear

fuels produce no fly ash, sulfur oxide or other hydrocarbon combustion air pollution products and have a much higher BTU content per unit consumed (whether by weight or volume). Moreover, both refining and combustion processes are being developed to decrease markedly the pollution problems caused by oil and work is proceeding rapidly on developing "synthetic" natural gas by hydrogenation of coal. Consequently, processed (methane) gas is an excellent fuel but is by no means the ideal fuel. Nevertheless, because of quality, convenience and price (which is artificially lowered by Federal Power Commission Regulation of the commodity), processed gas-methane is a preferred fuel with a growing demand.

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**f. Monopolistic characteristics of independent producers.**

Finally, *independent* production of and sale of unprocessed unassociated or casing-head gas at the wellhead, as distinguished from its processing, transportation and distribution and sale to ultimate consumers, is not monopolistic, but competitive. The competition is as great or greater than among other fuels such as coal, lignite, oil, liquefied petroleum condensates, liquefied petroleum gas, and uranium, in addition to other industries such as automobiles. Independent production is not a natural monopoly like the public utility-distributors are, nor a potential monopoly as a result of economic combinations, collusions or other forces. Such things as transporters, integrated transporter-producers, or integrated distributor–producer-transporter combines could be and might justify special legislative treatment.

As a matter of fact, in 1970, according to the Federal Power Commission itself, there were over 4,600 independent producers engaged in interstate sales of natural gas for resale and 70 independent producers controlled a total of approximately 85 percent of the interstate, sale for resale *market* nationwide. See Federal Power Commission Notice of Proposed

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Rulemaking (Exemption of Small Producers From Regulation), Docket No. R-393, July 23, 1970. Furthermore, new firms are entering the interstate sale for resale market. In 1962, 10 percent of this particular market was occupied by firms entering after 1960. See Hodges, Natural Gas: Price Regulation vs. Supply, unpublished Richard J. Gonzalez Lecture, April 23, 1970, College of Business Administration, University of Texas.

If production rather than markets is analyzed, the four largest producers at the national level controlled 32.1 percent of production and the eight largest producers controlled 37.6 percent of production as of 1962. By way of contrast, the production concentration for the four largest producers of all products in the United

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States was 40 percent, with many basic industries such as automobiles, copper, soap, glass, electric light bulbs, and photography equipment showing production concentration of 90 percent or above among the 4 largest producers of each product. See Hodges, *supra*.

Even disaggregating the national market on a regional basis, the top four gas producers in 1962 controlled only 24.7 percent of the Gulf Coast regional market for interstate sales, and 22.9 percent of the Mid-Continent-Permian Basin regional market for interstate sales for resale. Furthermore, the big four in the Gulf Coast Region are not necessarily the same big four in the Mid-Continent-Permian Basin Area. See Hodges, *supra*.

Since other fuels are substitutable for natural gas as fuels for both domestic and industrial use, the monopolistic argument is even less valid. In fact, the independent producers of unprocessed unassociated or casing-head gas were described by Mr. Justice Harlan as "intensely competitive vendors of a wasting commodity they have acquired only by costly and

often unrewarded search." See, *In Re Permian Basin Area Rate Cases*, 390 U.S. 747 at 757 (1968). Consequently, natural gas production and producers cannot be classified as unique from other fuel and energy source commodity producers such as coal, lignite, oil, liquid petroleum condensate or uranium in terms of monopolistic characteristics.

### g. Conclusions

Because of the above factors, legislative classification of independent producers of unprocessed unassociated or casing-head gas appears to be more than *unwise, improvident or out of harmony with a particular school of thought*. If it were *only* those the classification would not meet the test necessary for constitutional invalidity. See *Williamson* v. *Lee Optical Co. of Oklahoma, supra.* Instead it appears to be clearly arbitrary.

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This arbitrary classification of independent gas producers has created a closed class of unregulated fuel producers and is invidiously discriminatory against the regulated independent producers, because all are producers of a similar commodity, and only one has been singled out for federal price ceilings.

This is not to say or even imply that the Natural Gas Act of 1938 is unconstitutional or even that its application to regulate prices of gas "sold" by integrated producer-transporter companies to themselves or their subsidiaries on a non-arm's length basis are unconstitutional. It is the application of the Act to the independent producers that is unconstitutional.

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* * * * *

Respectfully submitted,

/s/ EDWARD H. FORGOTSON

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*Counsel for*
[James M. Forgotson, Sr]
[September 14, 1970]

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**APPENDIX A**

Title 15 § 717 (b), U.S.C.

(b) The provisions of this Chapter shall apply to the transportation of Natural Gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

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BEFORE THE

FEDERAL POWER COMMISSION

| | |
|---|---|
| In the Matter of | Docket No. |
| EXEMPTION OF SMALL PRODUCERS FROM REGULATION | R-393 |

VIEWS AND COMMENTS
OF
TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC.

Pursuant to the Notice of Proposed Rulemaking issued by the Federal Power Commission in Docket No. R-393 on July 23, 1970, Tennessee Gas Pipeline Company, a Division of Tenneco Inc., (Tennessee) submits the following views and comments in response to the proposed Regulations.

I

In this rulemaking proceeding the Commission proposes Regulations which, with the exception of an annual reporting requirement, will totally exempt "small producers" from regulation under the Natural Gas Act. The main purpose of the proposed rule, as stated by the Notice, is to "relieve small producers in all areas of almost all the expenses and burdens connected with regulatory matters . . . and to encourage them to increase their exploratory efforts . . ." While Tennessee supports the Commission's efforts to reduce the burdens of and simplify "small producer" regulations, it feels that the subject proposal will raise several perplexing problems.

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II

The basic problem with the Commission's proposal, and which, no doubt, will cause much future confusion in the event the proposed rule is adopted, is the apparent lack of statutory authority for the Commission to exempt "small producers" from regulation under the terms of the Natural Gas Act.

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In the Notice the Commission states that the ground work for the proposed exemption was formulated in Opinion Nos. 468 and 546. In addition, the Commission cites certain dicta in Justice Clark's majority opinion in *FPC* v. *Hunt*, 376 U.S. 515 (1964).[1]

The Commission in discussing the "small producer" problem in Opinion 468 said the following:

> While we are convinced that there is a need for distinctive treatment for small producers . . . we do not believe it is necessary or desirable to provide outright exemption. We reach this conclusion assuming that exemption is legally permissible despite the mandatory language of Sections 4 and 7 of the Natural Gas Act.[49]

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[49]Section 4(a) states in part that "*all* rates and

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[1]In *FPC* v. *Hunt*, *supra*, and *Wisconsin* v. *Federal Power Commission*, 373 U.S. at 329 (1963) Justice Clark suggested that the Commission look to the National Labor Relations Board for a method of handling exemptions. These exemption practices consisted of the National Labor Relations Board ceding its jurisdiction in certain cases to state or territorial agencies. Therefore, there would remain a body with jurisdiction over labor disputes if the National Board chose not to take the case. There are no similar state or territorial agencies which could regulate the "small producer" sales of natural gas for resale in interstate commerce.

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Thus, the Commission itself has expressed serious doubt that a full exemption of "small producers" would be legally permissible. In this same vein, it should be recalled that the Supreme Court in the *First Phillips* case made no reference to the size of the natural gas producers in holding that Congress intended that their sales of gas for resale in interstate commerce should be regulated by the Federal Power Commission.[2]

III

Another aspect of the proposed rule which the Commis-

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charges" by "any natural gas company shall be just and resonable." In Section 4(c) it is stated that "under such rules and regulations as the Commission may prescribe, *every* natural gas company shall file . . . . in such form as the Commission may designate, . . . *all* rates and changes . . ."

Section 7(c) provides in part that "No natural gas company . . . shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity . . ." (emphasis in original)

[2]*Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. at 682. The Court said: ". . . we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." This same language was quoted by the Fifth Circuit in *Deep South Oil Co. of Texas* v. *Federal Power Commission*, 247 F.2d 882, 887. In that case the Court held that Deep South (described as "a small, unintegrated corporation engaged in the exploration for and the production of oil and gas") was a "natural gas company" within the meaning of the Act.

sion should consider is that upon termination of existing gas sales contracts, "small producers" apparently will be free to enter new contractual arrangements, either on a jurisdictional or a non-jurisdictional basis. In this regard, at least two serious questions are raised: (1) would a pipeline company be assured of recouping its cost in paying the "going" field price to the "small producer" in order to keep the remaining reserves? and (2) if the remaining reserves are contracted to another purchaser (jurisdictional or non-jurisdictional), would the present pipe-

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line purchaser be required to obtain abandonment authorization for his gas purchase facilities before the purchases could be terminated? See: *United Gas Pipeline Company v. Federal Power Commission*, 385 U.S. 83 (1966).

IV

Under the proposed Regulations a person would qualify as a "small producer" to the extent that he sells less than 10,000,000 Mcf annually. While it is unclear what would happen if a "small producer" exceeded the above volume, it should be anticipated that a "small producer" would consciously withhold sales, and where possible deliveries, of gas near the end of the year rather than lose his "small producer" exemptions. This withholding would occur, of course, during the cold months of November and December, when natural gas is in a period of great demand.

V

Under existing Regulations [Section 154.91(b)] the Commission recognizes that in many instances jurisdictional sales of natural gas may be made, although the purchasing pipeline has *no* contractual relationship with the producers of the natural gas. Such situations arise (1) when a plant or property operator purchases natural gas from another on a percentage-of-the-proceeds basis and resells such gas to a pipeline and (2) when a plant or property operator sells natural gas to a pipeline under a

gas sales contract which has not been signed by a co-owner of the gas producing property, *i.e.*, a "non-signatory co-owner" situation. Under present Regulations, neither a "percentage formula" seller nor a "non-signatory co-owner" may file certificate applications, rate schedules

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or rate schedule changes. However, before such sales can be terminated, the seller must secure abandonment authorization from the Commission. See: Sections 154.91(d) and 154.91(e).

In the text of the Notice, the Commission specified that the proposed exemption "would not include percentage sales made by small producers".[3] Apparently, such sales would remain subject, *inter alia*, to the abandonment provisions of the Natural Gas Act and the existing Regulations. The proposed Regulations, however, are not so clear with respect to "small producer" "non-signatory co-owner" sales, particularly in view of existing Regulations (154.91(d)) which allow a "non-signatory co-owner to take his gas in kind" and dispose of it on some other basis, provided he first obtains, *inter alia*, Commission abandonment authorization under Section 7(b) of the Natural Gas Act.

If the Commission intended that "small producers" in "non-signatory co-owner" situations should be free "to take their gas in kind", then at least two significant problems must be considered from the purchasing pipelines' point of view.

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[3]In proposed Section 157.40(a) (3) (iii), defining "small producer sales", the Commission included "sales of a small producer's interests under another producer's contract". This is apparently inconsistent with the announced intention that "percentage formula" sales by "small producers" *would not be* subject to the exemption. On the other hand, proposed Section 157.40(a) (1) would exclude volumes sold by a "small producer" under percentage contracts in determining whether the particular producer sold in excess of 10,000,000 Mcf annually.

First, it should be anticipated that small non-signatory co-owners will seek alternative dispositions for their gas, perhaps to non-jurisdictional markets. Second, if an operator for a small

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non-signatory co-owner continues to deliver gas to the existing purchaser after an exemption is granted, serious uncertainties may arise as to the pipeline's obligations to the various interest owners, particularly those that are exempted and with whom the pipeline has no direct contractual relationships.

VI

In the Notice, the Commission states the proposed exemption would not apply to "percentage sales made by small producers." It is unclear whether the Commission intended to include royalty gas within the "percentage sale" concept. In this respect the Commission held in *Denman, et al.*, Opinion No. 562, 42 FPC 164 at 174, that the royalty payment provisions in a lease from which a jurisdictional sale was made constituted "a sale for resale of natural gas in interstate commerce subject to regulation under the Natural Gas Act".

VII

There are potential accounting and billing problems arising out of this proposed rule. Tennessee is largely dependent upon the operator's invoice for any breakdown of the total volume received at a delivery point which involves a commingled gas stream. Classification of volumes of gas would have to be set out on invoices by rate schedules and "small producers" volumes (shown by each small producer and not in the aggregate) in cases where the operator is billing for both large producer gas and "small producer" gas. As a minimum, verification of "small producer" volumes by the operator should be required by the Commission.

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There are also problems concerning the status of a producer. On page 3 of the Notice, the Commission states that:

> "producers who have received small producer certificates under the present provision of Section 157.40 or who have applied and qualify but have not yet received such a certificate would not be required to file new applications unless otherwise directed in any order issued herein."

A pipeline may not have been served with these producer applications and thus may be unaware that they qualify as "small producer". "Small producers" should, therefore, be required to show a certificate or other proof of their "exempt" status when selling gas to the pipeline company.

VIII

The present Regulations recognize that frequently one producer will assign to another producer all or part of an interest in a gas producing property which is covered by an effective gas sales rate schedule. See Sections 154.92(d)(1)(2)(3), and 157.24 of the Regulations. Generally speaking, these Regulations provide for filings by the assignee for authorization to continue a sale and to provide for any refund obligations which may be imposed with respect to gas deliveries either before or after the assignment. Under the Commission's proposal "small producers", as assignees of gas producing properties from "large producers", apparently would not be required to make the filings required by the present Regulations. As a result, the pipeline purchaser could be exposed to considerable uncertainty as to its obligations with

respect to dedicated acreage and/or reserves subject to a contract and rate schedule, particularly

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in situations where only a partial assignment of interest is made by a "large producer" to a "small producer". See: *Skelly Oil Co.,* 35 FPC 849 at 856; *Turnbull and Zoch Drilling Co.,* 36 FPC 164 at 166.

IX

In the Notice, the Commission states in the first paragraph that it proposes to *prospectively* exempt from regulation all existing and all future jurisdictional sales made by "small producers". However, proposed Section 157.40(b)(1) provides that "small producers may apply for exemptions to cover all *previous* and all future jurisdiction sales . . ." The use of the word "previous" seemingly is inconsistent with the earlier use of the word "prospectively". In order to avoid any possibility that the proposed exemptions would apply retroactively, it is suggested that the word "previous" be changed to "existing".

X

In the event it is determined that a conference is necessary, we respectfully request notification thereof. Correspondence with respect to the Commission's proposals in Docket No. R-393 should be addressed to each of the persons shown below.

Respectfully submitted,

TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC.

By /s/ Michael W. Moore
MICHAEL W. MOORE
ATTORNEY

Harry S. Welch
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Attorneys for
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A Division of Tenneco Inc.

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

| | | |
|---|---|---|
| Exemption of Small Producers | ) | |
| From Regulation | ) | Docket No. R-393 |
| | ) | |

COMMENTS OF GLOVER HEFNER KENNEDY OIL COMPANY UPON PROPOSED RULEMAKING

Glover Hefner Kennedy Oil Company (GHK), pursuant to the Commission's Notice issued July 23, 1970 in the captioned docket, hereby submits its comments upon the proposed rulemaking in such docket. In support hereof, GHK states as follows:

I.

GHK is a partnership with its principal place of business at 1010 Kermac Building, Oklahoma City, Oklahoma 73102. Communications or correspondence relating to these comments should be addressed to:

Robert A. Hefner, III
Managing Partner
Glover Hefner Kennedy Oil Company
1010 Kermac Building
Oklahoma City, Oklahoma 73102

II.

GHK is a small producer,[1] with extensive natural gas lease

[1] According to the criterion specified in the proposed rule and in §157.40 of the Commission's Regulations, viz. total jurisdictional sales not in excess of 10,000,000 Mcf annually.

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exploration and development operations concentrated almost exclusively in the Anadarko Basin of Oklahoma and Texas, and at depths therein below 15,000 feet.

GHK was created in the late 1950's for the express purpose of exploring for and developing natural gas reserves in the deep protion of the Anadarko Basin. GHK's operations accordingly are gas-oriented, and necessarily are carried out by a staff highly specialized and expert in the fields of deep gas technology and exploration.

GHK began exploration in the deep Anadarko Basin in 1959, and has expended over $25 million in partially developing leases acquired upon approximately 250,000 acres, including $5 million for geophysical data. The vast amount of geophysical, geological and other information accumulated by GHK convinced it that the deep Anadarko contains untapped reserves in the range of 50 to 100 trillion cubic feet. GHK also was aware of the high cost of drilling to depths of 20,000 to 25,000 feet, but believed that the magnitude of anticipated reserves discoveries could justify such costs, assuming, of course, that sufficient compensation could be obtained from gas sales to cover costs, and return funds for further development operations. Accordingly, upon completion of its initial well in the deep Anadarko, the Green 1-1 Well in Beckham County, Oklahoma, at a depth of 24,452 feet, and at costs in excess of $4.5 million, GHK executed a gas sales contract at an initial rate of 21.0 cents per Mcf. Although GHK knew

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that the so-called guideline price in the area was 15.0 cents per Mcf, GHK believed that it could derive some price relief, albeit prospectively, after a short time through expeditious Commission action upon its certificate application, filed in early February, 1970, proposed rate increase after certification, and possibly in the Hugoton-Anadarko Area Rate Proceding, Docket

No. AR64-1, *et al.* However, delays ensued. A certificate was issued in late May, almost four months after filing, at a conditioned initial rate of 15.0 cents per Mcf;[2] and GHK's proposed rate increase filed in late May, was placed under suspension expiring in late November. Thus, for approximately 10 months, absent action in Docket No. AR64-1 compelling a different result, GHK will have been deprived of almost 29 per cent of its annual contract revenue, or approximately $84,000 with the prospect thereafter of having to make refunds of amounts collected above the "just and reasonable" rate. It is obvious that these funds, which could have been reinvested in further-development of GHK's properties, were irretrievably lost as a direct result of statutory and administrative delays attributable to Commission regulation. This example

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should make quite clear the inhibiting effect upon a small producer's exploration and development program which regulation under the Natural Gas Act, and particularly artificial, unreasonably low "guideline" prices, has had. GHK believes that such regulation could very well squelch otherwise aggressive and innovative E & D programs by it and other small producers.

III

GHK thus strongly supports the small producer exemption proposed in this docket.[3] While adoption of the rule cannot

[2] This 15.0 cents rate applies also to sales of gas from much shallower, lower-cost Oklahoma wells. There thus is no incentive for deep exploration where gas produced from a well completed at a cost of $4.5 million, as here, receives the same initial price as a shallow well costing $100,000.

[3] GHK supports as well any proposal to exempt from regulation under the Natural Gas Act all entities, including major producers, which make sales of natural gas in interstate commerce for resale, and which reinvest revenues derived from such sales in exploration for, and development of natural gas reserves.

erase past revenue losses and consequent declining rates of exploration, the proposed exemption is in the public interest for the following reasons:

A. Prescription by the Commission of the prices which the small producer could realize for his gas has had effects well beyond restricting return on investment. Such price regulation, appreciably and adversely has affected the small producer's principal source of funds with which to finance the search for gas and development of reserves once discovered, *viz.* firm revenues from current sales. In this regard, small producers, have been at a comparative disadvantage in raising

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funds for such purposes. A gas-oriented small producer such as GHK, in contrast to most major producers, does not have other operations, *e.g.* petroleum refining, to subsidize natural gas E & D activities. Similarly, sources of debt capital available to large integrated companies may not be readily tapped by small producers. Further, as a direct consequence of regulation, prices for gas sold by small producers have been neither adequate, nor even firm in many cases, thus, leaving small producers without any dependable source of capital for funding exploration and development.

In the present nationwide gas supply shortage situation, which by all indicators in the absence of corrective regulatory steps may last for an appreciable time, the proposed exemption would have the effect of permitting gas to be sold by small producers at generally higher contract prices, and thus would foster rejuvenation of E & D programs by small producers such as GHK. This result should follow naturally from the mere absence of the applicability to small producers of the artificially low guideline prices governing producers' initial sales prices which prescribed ten years ago and unrevised today to reflect current conditions, have proved an impediment to intensive

exploration and development, the best evidence of which is the supply shortage itself.

It is particularly crucial for the Commission to encourage the revitalization of E & D programs by small producers

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in the deep Anadako Basin because of the sheer immensity of untapped reserves in that province, because small producers are the vanguard of deep drilling efforts, and because the province is traversed by 15 interstate pipelines, all of which means that successful development of the area would *significantly* contribute toward alleviation of the gas shortage. Adoption of the proposed exemption by allowing effectuation of small producers' contract prices, would reinstitute the viability of the small producers' principal source E & D capital–revenues from current sales–and this in turn would provide a definite incentive for needed revitalized E & D activities.

B. Without doubt, implementation of the proposed rule would also have the effect, beneficial to the consumer of "jurisdictional" gas, of allowing interstate pipeline companies to complete effectively with intrastate purchasers for small producers' natural gas reserves, large blocks of which have in recent years been diverted to the intrastate markets because of higher prices which such producers received from intrastate buyers.

West Texas provides the best documented example of this fact. A producer of "new" gas from the Permian Basin must accept a discount averaging 23% and going as high as 31% to make sales to the jurisdictional market. Top price for gas in the jurisdictional

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market is 16.5 cents for new gas, while purchasers in the

intrastate market have paid up to 23.99 cents. If the jurisdictional market had been competitive during 1968 and 1969, some part of the 130 billion cubic feet of new annual production going to the intrastate market during those years could have been sold in interstate commerce. Under the exemption proposed, at least in the near term, small producers' wellhead (contract) prices for such reserves will tend to rise. However, even at wellhead rates up to 30-35 cents per Mcf, the ultimate consumer still should be paying prices less than, or approximately the same as those now paid for Canadian natural gas or foreign LNG, both of which have been used increasingly by distributors to supplement declining domestic natural gas supplies. Such being the case, it is more in the interests of the United States and gas consumers for the Commission to stimulate domestic production rather than subsidize foreign production. By allowing small producers to sell gas at contract prices, an effect of exemption from price regulation, the proposed rule would so serve national interests.

C. As the Commission is aware, a serious problem encountered by small producers, caused by the mere fact of regulation, is the irretrievable loss of cash flow resulting from shut-in wells awaiting certificate authorization. Facts stated above as to GHK's own

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situation illustrate the problem. That the problem is representative among small producers was recognized by the Commission in its opinion in the *Permian Basin Area Rate Proceeding*, 34 FPC 159, 235 (1965):

> "We recognize the burdens to small producers of complying with the filing requirements promulgated pursuant to Section 7 of the Natural Gas Act before new gas supplies can be connected. Such filings, which

are routinely handled by the larger companies can, in the case of a small producer, strain his resources. The time lag, even the few weeks required under our expedited procedures, can deprive a small producer of badly needed income."

Effectuation of the small producer exemption would eliminate such losses caused by delays inherent in regulation, as well as free the Commission's administrative resources for expeditious and thorough attention to matters involving large producers and others, and thus is in the public interest.

IV

As part of the small producer exemption, the Commission should relieve small producers of their potential refund obligations under temporary certificates and Section 4(e) proceedings. To enforce such contingent liabilities would be contrary to the basic purposes of the exemption and would offset its beneficial effects, *viz*, emancipation of funds for E & D.

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Alternatively, however, the Commission could lift such refund obligations upon the condition that refund monies be employed for exploration and development of reserves. Refunds would not thus technically be "forgiven," but merely alternatively channelled. In such a manner, the Commission could be assured directly that such funds would be used for the benefit of ultimate consumers by potentially increasing gas supplies.

V

GHK does not request a conference to discuss the proposed exemption, but desires to be informed of any conference scheduled to be convened by the Commission so that its repre-

sentative may attend.

WHEREFORE, for the foregoing reasons, GHK urges the Commission (1) to adopt the amendments to its Regulations as proposed in its Notice of July 23, 1970 in this docket, and (2) to adopt additional amendments relieving small producers from refund obligations under temporary certificates and rate proceedings, or alternatively to provide that refund amounts under such contingent

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obligations may be employed for exploration and development of natural gas reserves, in lieu of refunds to purchasers, provided that sufficient assurance is given to the Commission that such amounts will be so employed.

Respectfully submitted,

GLOVER HEFNER KENNEDY OIL COMPANY

September 14, 1970.

By: s/s Robert A. Hefner, III

Robert A. Hefner, III
Managing Partner

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

| | |
|---|---|
| Exemption of Small producers )<br>From Regulation ) | Docket No. R-393 |

COMMENTS AND RECOMMENDATIONS
OF
CONSOLIDATED GAS SUPPLY CORPORATION

Consolidated Gas Supply Corporation (Consolidated Supply) hereby submits its comments and recommendations in response to the Commission's Notice of Proposed Rulemaking, issued July 23, 1970, in the above-entitled matter.

Consolidated Supply is an operating subsidiary of Consolidated Natural Gas Company, a registered public utility holding company, and is a natural gas company within the meaning of the Natural Gas Act, subject to the Commission's jurisdiction thereunder. Consolidated Supply and its affiliates comprise the Consolidated Natural Gas System, which serves market areas in New York, Ohio, Pennsylvania and West Virginia. Consolidated Supply, which is the principal supply arm of the Consolidated System, depends for a relatively small but nonetheless substantial and critically important portion of its gas supplies upon contracts with small producers as defined in the proposed regulations, particularly in the Appalachian Area. Consequently, Consolidated Supply has a vital interest in the subject matter of the rule-making proposed in this Docket.

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Small Producer Exemption Proposed
Needs Modification

The proposed regulation would exempt small producers with respect to their small producer sales of natural gas in inter-

state commerce under the Natural Gas Act, apparently including (1) certificate regulation under Section 7(c) and (e); (2) rate regulation under Sections 4 and 5; and (3) abandonment regulation under Section 7(b). The regulation proposed would prescribe the forms of application for exemption and annual statements to be filed by producers holding small producer exemptions.

The proposed regulation should, for the reasons stated below, be modified as follows:

(A) Small producers should be exempt from certificate and rate regulation only to the extent that their small producer sales are made at rates not in excess of applicable ceiling guideline rates or just and reasonable area rates, if the latter have been determined for the area, subject to a provision for petitioning for amendment or waiver permitting higher prices, as suggested in the Commission's Notice of Proposed Rulemaking issued October 16, 1969, in Docket No. R-371;

(B) Small producers should be exempt from compliance with Section 7(b) of the Natural Gas Act with respect to the abandonment of their small producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment; and,

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(C) Annual statements by small producers should be expanded to show, in addition to the volumes of annual sales as proposed in Attachment B to the Commission's Notice herein, by areas and jurisdictional purchasers the volumes sold and the prices charged (including what part, if any, constituted production or severance tax reimbursement).

The indicated purpose and effect of the proposed exemption would be to relieve small producers of the many expenses

and burdens of complying with Commission regulatory requirements, and it would also relieve the Commission, its Staff and the jurisdictional purchasers of many of these burdens and expenses. Considering the great number and usually routine nature of the filings now being made by small producers and the relatively small amounts of gas involved with respect to each such filing, the purpose of the proposed regulation is highly salutary and should be achieved.

The proposed regulation goes further than is necessary to achieve the commendable purpose referred to and conceivably could prove to be unnecessarily expensive to gas consumers, in view of the nation's current critical gas supply situation. The Commission's Notice herein suggests that the impact of exempting small producers from regulation should be minimal because they account for a relatively small share of the natural gas produced nationally, and, as a practical matter, small producers are normally not in a position to obtain more for their sales than the large producers whose sales are subject to FPC ceilings in each area. Although this may be true for the country in large part, it is doubtful that

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such assumed economic and competitive restrictions prevail, at this time, in the Appalachian Area. As the Commission has pointed out in its Notice Of Proposed Rulemaking in Docket No. R-371, a preponderance of nonpipeline-produced gas in the Appalachian Area is produced by small producers, and the vast majority of sales in that area is made by small producers. In normal circumstances–with ample supplies available–the alternate cost of purchasing Southwest gas at delivery points in the Appalachian Area could act as an effective upper limit for prices for gas produced in that area. This alternative, and its restraining effect upon prices, does not now exist because gas to meet the increased market requirements in the Northeast is simply not available from the pipeline companies serving that

area from the Southwest. Since neither the prices obtainable by the few major independent producers in the Appalachian Area nor the rates at which new supplies of gas are *not now available* from the long pipelines serving that area set any kind of effective economic limit to the rates obtainable by the small producers, the continued imposition of ceiling prices by the Commission upon small producer prices in the Appalachian Area, or any other areas of the nation which are vitally dependent upon local small producer sales, is essential if the consumer is to be protected against imposition of increased prices greater than those necessary to elicit additional supplies.

In areas of the nation where small producer sales are in the minority, and thus where small producers cannot obtain contracts for prices higher than those obtained by the regulated major producers,

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imposition of a requirement that small producers must file with your Commission for authorization to make sales in excess of ceiling rates would impose no burden.

Certainly, the existing applicable producer rate ceilings in the Appalachian Area are too low to provide necessary additional supplies, and Consolidated Supply has urged and will continue to urge that they be raised promptly and substantially in both Docket Nos. R-371 and R-389A.

With respect to abandonment authorizations for small producers, the vast majority of these are routine matters occurring because of depletion of production or circumstances which have made continuance of the sale to the pipeline purchaser uneconomical. The pipeline purchasers in these situations routinely consent to the abandonment of the sale, and Consolidated Supply sees no necessity under the Natural Gas Act for the Commission to be involved with the processing of these routine and uncontroverted abandonments. Only in the rare

situation in which there might be a dispute as to whether a small producer sale should be discontinued should there be some procedure whereby a Commission determination can be had as to whether the abandonment is permitted by the present or future public convenience or necessity.

The additional data suggested for inclusion in the annual statement form to be filed by producers holding small producer exemptions would impose very little, if any, burden and, at the same time, would provide information that would be useful to both the Commission and the public.

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Waiver Of Commission Regulations To Permit Tracking Of Rate Increases Resulting From Exemption Of Small Producers

The Notice herein also states that the Commission proposes to waive the provisions of Section 154.63 of the Regulations solely to permit the tracking of the rate increases resulting from the exemption of small producers, provided that (1) where present orders governing tracking by the pipeline purchasers are not involved, the supporting schedules required by Section 154.63 shall be filed within four months, and (2) the rates as revised by such tracking shall be subject to reduction and refund from their effective date. Apparently this is an announcement of a policy which the Commission proposes to adopt, but it is not proposed that this policy be embodied or the mechanics of its application set forth in the proposed regulations.

It should be noted that, if the Commission's proposal to exempt small producers from rate regulation be modified as suggested by Consolidated Supply herein to permit such exemption only where the rates charged are not in excess of applicable ceiling rates, then questions concerning the tracking of increased costs resulting from the exemption of small producers should be moot.

However, assuming that the Commission exempts small producers from rate regulation without the qualifications suggested by Consolidated Supply, it seems likely that rate increases resulting from the exemption of small producers will form only a small part of the increases in cost of gas which pipeline purchasers and pipelines purchasing from such pipeline purchasers are virtually required

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to track under the Commission's decision in Texas Eastern Transmission Corporation.[1] Further, pipelines purchasing from pipeline purchasers are also confronted with the necessity of tracking general rate increases, including but not limited to producers' price increases, filed by the pipeline purchasers. It would appear to be administratively chaotic both for the Commission and for the pipelines if one set of rules is to be applied to the tracking of that portion of supplier cost increases which is due to rate increases caused by exemption of small producers, and another set of rules is to be applied with respect to the rest of the jurisdictional increased supplier costs which pipelines must track.

For these reasons, Consolidated Supply urges that this is not an appropriate proceeding in which to determine rules, conditions and procedures for the tracking of rate increases resulting from the exemption of small producers. If the Commission believes it appropriate to establish rules concerning tracking of supplier cost changes in a rulemaking proceeding, rather than considering the problems of each pipeline company on an *ad hoc* basis, then Consolidated Supply urges that a separate proceeding be instituted to consider procedures for tracking the net effect of all changes in gas supply costs which must be tracked. The attention and the comments of the industry and others affected could then be focused

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[1] *Texas Eastern Transmission Corporation*, 39 FPC 630 (1968), rehearing denied 40 FPC 62, affirmed, *Texas Eastern Transmission Corp. v. FPC*, 414 F.2d 344 (5th Cir. 1969), cert. denied ____ U.S. ____, 26 26 L.Ed.2d 89 (1970).

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on tracking problems in a proceeding concerned primarily with that subject rather than in this proceeding, in which only a minor portion of the tracking problems are involved incidentally.

If, however, small producers are to be permitted to charge higher rates than large producers, and the problems of tracking resultant cost increases are to be considered in this proceeding, then Consolidated Supply takes serious exception to the proposed policy as announced in the Commission's Notice herein.

First, in the Appalachian Area and other areas where escalation clauses in producer contracts are not common, the increased cost effect from exempting small producers will not lie primarily in rate increases, which is all that it is proposed in the Notice to permit pipeline purchasers to track; rather, the substantial cost effect will result from the replacement of continually-diminishing supplies under existing contracts with new contracts covering new supplies at higher, unregulated prices. It is the increase in the average cost of gas which needs to be tracked in some fashion, rather than price increases only.

Second, schedules and such supporting data as may be required to support tracking increase calculations can and should be furnished very promptly, in much less than four months. These are relatively simple and minor compared to the schedules required by Section 154.63, even if limited to Statements L through N. The latter require compilation of voluminous data, most of which have nothing to do with a tracking increase and should not be required.

Third, as to the requirement that the rates as revised by the tracking filings shall be subject to reduction and refund, it may

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first be noted that this requirement does not state that only the increased portion of the revised rates shall be thus conditioned.

Rather, the Notice seems to say that once a pipeline tracks a rate increase imposed on it by the Commission by exemption of small producers, the pipeline's entire revenues become subject to refund retroactively to the date of the increased rates. The unfairness of this proposal, even if limited to the increased portion of the revised rates, need not be belabored here, particularly in view of the fact that the small producer increases to be tracked would be firm rate increases under the Commission's proposed policy.

Communications in regard to this proceeding should be addressed, in addition to the undersigned, to Henry P. Sullivan, General Counsel, Consolidated Natural Gas Company, 4 Gateway Center, Pittsburgh, Pennsylvania 15222, and David E. Weatherwax, General Counsel, Consolidated Gas Supply Corporation, 445 West Main Street, Clarksburg, West Virginia 26301.

Consolidated Supply does not request a conference to discuss the proposals involved herein; however, it does desire to participate if a conference is convened by the Commission in this proceeding.

Respectfully submitted,

CONSOLIDATED GAS SUPPLY
CORPORATION

By /s/ Norman A. Flaningam
NORMAN A. FLANINGAM
Its Attorney

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## FEDERAL POWER COMMISSION

In the Matter of:

Docket No. R-393

Exemptions of Small Producers
from Regulation

GAO Building,
Room 2043,
Washington, D.C.
Tuesday, December 8, 1970

A conference on the above-entitled matter was convened at 10:00 o'clock, a.m., pursuant to notice.

PRESENT:

FRANCIS J. GILMORE (Presiding)
JOHN F. JOSEPH, Federal Power Commission Staff
RICHARD F. GENERELLY, Callery Properties, Inc., and Eason Oil Company
S. BLICKMAN, FPC-OEC
JAMES McCARRICK, FPC-ARD
W. B. MAXWELL, Colonial Gas
C. G. KREBS, Krebs Oil Company
R. H. ADKINS, MDP Producer
JAMES P. McKINNEY, Jr., Signal Oil and Gas Company
MICHAEL P. KELLY, Signal Oil and Gas Company
ROBERT J. HAGGERTY, Atlantic-Richfield
E. B. CURRY, Sweetland Land and Min. Co.
T. D. KAUFFELT, Attorney for Sweetland Land and Min. Company

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PRESENT (Continued)

EDWARD H. FORGOTSON, Attorney for J. M. Forgotson

ROBERT O. KOCH, Texas Gas Transmission Corporation

CHRISTOPHER T. BOLAND, Tes Gas Transmission Corp.

CHARLES V. SHANNON, Michigan Wisconsin Pipeline Company

M. W. MOORE, Tennessee Gas Pipeline Company

PHILLIP D. ENDOM, Tennessee Gas Pipeline Company

JAMES A. MASTERSON, Prenalte Corporation

WAYNE OGDEN, Tennessee Gas Pipeline Company

JAMES R. McCOTTER, Northern Pump Company

PHILIP R. EHRENKRANZ, Glover Hefner Kennedy Oil Company, Inexco Oil Company, Ladd Petroleum Company, Woods Petroleum Company

HARRY B. SHEFTEL, OMB

TOM C. McCORKLE Pan American Petroleum Corporation

JOHN L. WILLIFORD, Phillips Petroleum Company

KENNETH HEADY, Phillips Petroleum Company

ROBERT W. HENDERSON, Hunt Oil Company, et al

DAVID R. FRICK, Northern Illinois Gas Company

PHILIP S. PAUL, Southern California Gas Company

E. A. STANSFIELD, Western Slope Gas Company (Intrastate Company), Room 990 550-15th St., Denver, Colorado 80202
RAY W. RICHARDS, Panhandle Prod. Company
EDWIN S. NAIL, Amerada Hess Corporation
NORMAN A. FLANINGAM, Consolidated Gas Supply Corp.
RICHARD B. GORDON, Consolidated Gas Supply Corp.

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PRESENT (Continued)

J. F. KEARNEY, Commonwealth Gas Corporation
REX D. FOWLER, Northern Natural Gas Company
WILLIAM I. POWELL, IPAA
JOHN E. WATSON, Tenneco Oil Company
JOHN P. FURMAN, Kansas-Nebraska Natural Gas Company
GEORGE E. BONNER, New York PSC
RICHARD A. SOLOMON, New York PSC
THOMAS F. JOYCE, Federal Power Commission Staff
EDWARD M. McMANUS, Federal Power Commission Staff
JOHN M. DONNELL, Federal Power Commission Staff
B. JAMES McGRAW, Gulf Oil Corporation
V. E. BOYER, Continental Oil
DAN BRUCE, Shell Oil Company
J. H. MORTON, Shell Oil Company
SAIDA SHAALAN, NERA
WILLIAM T. HARKOWAY, Consolidated Edison Company of New York

R. J. LEITHEAD, Cities Service Oil Company
FREDERICK MORING, AGD
JOHNATHAN E. GAINES (Donovan, Leisure, Newton & Irvine), the Pittson Company
KIRK W. WEINERT, Texaco Incorporated
TOM P. HAMILL, Mobil Oil Corporation

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PROCEEDINGS

MR. GILMORE: My name is Frank Gilmore. I am a lawyer on the staff of the Federal Power Commission. I will preside today at this conference concerning the rule making proceeding in R-393, the exemption of small producers from regulation, as proposed in a notice issued July 23, 1970.

This conference will be recorded; and if any of you want transcripts, you can arrange with the transcriber to get them.

I do not propose today to take any position with respect to various matters discussed here. This conference is essentially an opportunity for those of you who wish to make any further comments concerning the various matters which have been discussed this far in this proceeding.

I will pass an attendance sheet around, and it will be transcribed in the record after I get it in return.

For the benefit of the Reporter as well as the others in this room, when you stand up to speak, would you please state your name before you start making comments.

As to the format, there is no format set forth in the notice of this conference issued on November 18. I am open to suggestions as to how you would like to handle this conference. I would suggest that we discuss seriatim some of the issues involved here, but because of the large number of potential issues, I have just picked out three of the more important

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issues for seriatim discussion. Then I would suggest that anybody who wishes to make further comments simply make

them under a miscellaneous heading.

MR. ENDOM: I am representing Tennessee. If you do not comment, that does not constitute any sort of waiver of any rights or anything like that?

MR. GILMORE: No.

MR. ENDOM: Thank you.

MR. GILMORE: Is there anybody here who has not filed written comments who proposes to participate actively in the discussion here?

MR. KAUFFELT: I have filed no written comment.

MR. WATSON: My name is John Watson, and I am with Tenneco Oil. I did not file any comment, and I can't say whether I will participate. I don't have any plans to participate actively. I am here as an observer primarily.

MR. GILMORE: Let me suggest that if either one of you do, that you also file written comments, and that whatever you say here will be accepted subject to the Commission approving, let's say, your late entry with respect to the written comments.

The three issues that I wanted to take up seriatim were: first, the legality and feasibility of the proposed exemption.

Secondly, the exemption of a sale by one producer

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to another producer for resale to a pipeline. And the third matter is the extension of the exemption to present certificate and rate proceedings and the refund obligations relating thereto.

MR. BOLAND: Repeat the last one.

MR. GILMORE: Extension of the exemption to present certificate and rate proceedings and the refund obligations relating thereto.

MR. McKINNEY: I don't know whether this comes under legality or feasibility, but before getting into any of these questions, I would like to ask one question, at least to clarify the notice of proposed rule making issued by the Commission.

At the outset, in the first paragraph of the rule making, the Commission indicates that, "this would not include percentage sales made by small producers pursuant to percentage sales contracts."

I took it from reading that sentence that the exemption simply would not extend to present small producer sales under percentage sales contracts. Then I got back over into the ordering clauses, and although I suppose that those ordering clauses can be interpreted as excluding percentage sales by small producers, nonetheless it is not clear at all to me,

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and it seems to me that at the very least if that is what the Commission intended, there ought to be an expressed ruling out or exemption of that kind of sale from this rule making. But to me the introductory paragraph of the Commission's notice is contradictory to what is contained in the order itself.

I was wondering if the staff could comment on that as to what the notice of proposed rule making actually anticipates in that regard.

MR. GILMORE: I think it anticipates exactly what you indicated, that the small producer exemption would not apply to percentage sales contracts.

MR. ENDOM: Does the staff have a position with respect to statutory basis of this proposal?

MR. GILMORE: Wait just one second.

MR. McKINNEY: I have just one more question.

I take it then if it does not apply, that the present Commission regulations would require the seeking of abandonment authority by producers who are selling under

percentage contracts would still be equally applicable to those producers?

MR. GILMORE: That is correct.

MR. ENDOM: Excuse me. I believe you said earlier that the staff was not going to take a position in certain areas, but does the staff have a legal position with respect to the statutory basis for the proposed exemption?

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MR. GILMORE: No. I don't propose to take any position here.

MR. ENDOM: Well, it was said on the other question that percentage type sales would continue to be regulated, as I understand it?

MR. GILMORE: Under the proposed rule as noticed on July 23, 1970.

MR. ENDOM: That was one type of sale that Tennessee was concerned about.

The other type was the type of purchase where it is not a percentage sale, it is just a sale made under metal producers rate schedule in a non-signatory co-owner type of situation. The proposed rule did not actually address itself to that particular matter, but I was wondering what the staff's position is on that.

MR. GILMORE: I believe the non-signatory co-owner who was a small producer would be exempt under these provisions.

MR. FORGOTSON: You mentioned, concerning percentage sales to be regulated, in order for them to be deregulated, they would have to get abandonment permit first, is that right?

MR. GILMORE: They simply wouldn't be deregulated or exempted under the proposal in R-393, and the abandonment requirement would be the requirement which exists at the present time, and has existed for some time.

MR. KAUFFELT: Is there any question regarding the

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fact that a small producer is still defined as one producing ten million or less?

MR. GILMORE: Well, in the notice of proposed rule making, that is what the Commission proposed. Now, there have been, as you may know, various comments filed by parties suggesting alternatives to that.

MR. FORGOTSON: I would like to ask one more question about the percentage sales again.

If we are representing the trust department of a bank that holds a lot of royalties, and they are all taking a percentage of the net production of the person with the working interest–in order for them to be spearate–in most cases from the groups that would be non-exempt under this regulation, they would still be non-exempt, is that right, unless they on the basis of an individual well got into a Section 7 proceeding?

MR. GILMORE: I think you are discussing a problem which is substantially different than the problem Mr. McKinney brought up.

MR. FORGOTSON: That is what I thought it was.

MR. GILMORE: I wouldn't want to get it tied in. Mr. McKinney, as I understood him, was simply talking about a situation where a producer sells to a processing plant, or that is the most usual situation, and he gets a percentage of the resale price.

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MR. FORGOTSON: Okay, fine. Are we going to deal with the royalty owner in that other question?

MR. GILMORE: If you want to.

MR. FORGOTSON: I would like to know, because that is of critical importance when a person who has got a

non-operating interest and might decide they would like to take in kind, or would just take part of the sale, would they come in as percentage, would they be non-exempt because of this percentage sales non-exemption?

MR. GILMORE: I think the royalty problem, which you have posed, will have to be clarified if and when the Commission takes any action in this rule making proceeding.

MR. McCORKLE: Is it intended to exempt the royalty interest?

MR. GILMORE: I don't think it is clearly set forth in the notice how the royalty matters will be disposed of.

MR. FORGOTSON: The same would hold for small working interests, I take it, too.

MR. SOLOMON: Maybe you were saying this before I came in. On percentage sales they are excluded, irrespective of the size of the producer?

MR. GILMORE: They would not be included within any exemption granted to a small producer.

MR. SOLOMON: Rule making under percentage sales, 10 mcf, would fall under normal percentage sale?

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MR. GILMORE: That is right.

MR. ENDOM: Would a small producer at the expiration of his contract, would he have the obligation to make any filings with the Commission under the proposed rule?

MR. GILMORE: No.

MR. ENDOM: Would the pipeline?

MR. GILMORE: I think the pipeline's obligations would be not affected by this proposed rule as now proposed.

MR. HEADY: Would the volume of percentage sales be included in the total to be determined as to whether the small

producer still qualifies?

MR. GILMORE: I am going to have to check with Mr. McManus in the back of the room.

MR. McMANUS: Repeat the question.

MR. HEADY: Would the volume of percentage sales, which under this proposal would not be exempted, would that volume be included in determining whether a small producer had exceeded the total of 10 million mcf?

MR. McMANUS: Yes, it would.

MR. HEADY: I didn't understand a moment ago the answer to the question as to what happens when a percentage sale contract expires by its own terms. Does the seller under that percentage sales contract, if he otherwise qualifies, then become exempt upon the expiration of that percentage sales contract as to that sale?

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MR. SOLOMON: If he has a certificate or if he does not?

MR. HEADY: Under normal circumstances, the seller under a percentage sales contract would not have a certificate, can't get one.

MR. SOLOMON: But under this proposal, he would have to get a certificate, isn't that what the proposal calls for?

MR. HEADY: My question is related to the point–

MR. SOLOMON: I am just asking you.

MR. HEADY: I don't know. I am asking Mr. Gilmore.

MR. GILMORE: I indicated earlier that for a percentage sale, a producer, whether large or small, would still be required under the regulations to obtain abandonment authorization.

In other words, this rule making proposal wouldn't change anything in that regard.

MR. HEADY: Can a producer who is selling under a percentage contract obtain a certificate of exemption if his total sales do not otherwise exceed the ten million if he is in fact selling both under percentage sales and other type sales?

MR. GILMORE: A small producer can receive for his sales other than percentage sales.

MR. HEADY: If a producer has such a certificate at the time the percentage sales contract expires, does that

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sale then automatically come under his certificate of exemption as a small producer?

MR. GILMORE: I don't think so. Does anyone wish to discuss the problems involved in the sale by one producer to another?

MR. ENDOM: You raised a question of feasibility, and there is certainly a heck of a lot of billing problems which we would have, if some producers were selling at one price and we didn't have a contract with them, say a large producer was selling gas, and a small producer was selling gas under his rate schedule. His rate schedule apparently would not govern that small producer volume, and there is no contract between the pipeline and small producer in a non-signatory co-owner situation, there would be extreme difficulties as far as billing is concerned.

I guess that is just a comment. I can have our senior gas representative, gas contract representative, say a little bit more about that.

MR. GILMORE: If you wish, or if he wishes, you are perfectly free to do so.

MR. ENDOM: This is Mr. Ogden, and he is with Tennessee's Gas Contract Section.

MR. OGDEN: We basically see problems resulting from the physical accounting for the gas if these small producers are released.

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Presently our accounting system is set up whereby a single operator or multiple operators in a large field would handle the accounting with comingled gas coming in through our system. When you release the small operators which will be co-producers or signator to the contract, and many of them operating behind a rate schedule of the operator, which are non-signatory parties to the contract, and then they are free to file or go to the area price in situations where the operator has a rate settlement in effect, we see compounding of price structures and an accounting on an individual basis, which will considerably increase the problems of just keeping up with the gas when it still continues to come through the comingled meter.

Now, the Commission requires us to file by rate schedule all of the gas that is delivered into the system, and if you look at a large contract, you may have half a dozen signator parties, and behind that the various parties may be purchasing gas under operating agreements, and these are exempted.

We are not sure as to what the legal status as to the contract would be with these parties that are non-signator to the contract. And we feel that it will be a problem that will certainly increase our billing and accounting procedures that are presently operating in a satisfactory manner.

MR. GILMORE: Are there any further comments on the feasibility of the proposal?

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MR. FRICK: This is not directed so much to the feasibility, but raises a question, and I am asking for some clarification.

First of all, my name is David Frick. I am representing Northern Illinois Gas Company.

The question I have concerns the freedom from quality adjustments and the relation to BTU adjustment also, and the question that I have is, will BTU adjustments continue to be necessary in the proposed rule, or are they no longer necessary and–

MR. GILMORE: Under the proposed rule, the small producer as to his exempt sales will be entitled to his contract rate, whatever that may be. So that if the contract provides for adjustments, then they will be aplicable. If it doesn't provide for it, they won't be applicable.

But in any event, it will not have any relationship to the–or any necessary relationship to the ceilings which may be set in the various areas, for instance, in Permian or in Southern Louisiana.

MR. SOLOMON: My name is Dick Solomon. Let me ask you: have we got any information from the major producers as to whether effectuation of this rule would create for them the same type of problem that was created for them in the royalty case?

If exempt producer has contractual obligations with

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a major producer, who is subject to regulation, are we going to get into the same problems where a formerly thought of exempt royalty owner had dealings with major producers?

MR. GILMORE: There were a number of large producers who did file comments, pretty strong comments on that subject. I suggest that they speak for themselves on the matter.

MR. BRUCE: I am Dan Bruce with Shell. Our comments included some remarks in this regard. We can anticipate instances in our operations where we will be faced with contractual obligations that will be affected by this rule, and we don't know yet just how they might be handled.

We were in hopes somebody here might have some comments to make, and some suggestions as to how these

obligations that are fixed contractually are going to be dealt with by companies who have, we now find, an interest which was formerly contractual obligations which were arrived at during each fractional interest in, say, a unit or other plant operation, valued at uniform level, now turns out that they are not.

We have obligations which are fixed by contract, which would not automatically in every instance be changed just because the value of the interest may change because of this freeing of regulation of some of the producers.

I haven't heard anybody address themselves to this. We raised a question, but we don't have the answer.

MR. McCORKLE: I am Tom McCorkle. Our suggestion

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was that if the Commission proceeds in this rule making, that it should modify the definition of the small producer so as to explicitly and expressly exclude the royalty owners. Because the probability of the royalty owner, like some one mentioned–some trust relationship with the bank, and many of these royalty owner interests are going to be able to qualify apparently for an exemption, and if this occurs, you are going to have problems that apparently the Commission in its opinion 562 sought to avoid.

MR. GILMORE: Would your recommendation also exclude the exempt status with respect to royalties relating to small producer sales? Let's say the small producer sale itself is exempt. What about the royalties relating to that?

MR. McCORKLE: I think, as a matter of principle, if your definition of small producers exclude royalty interests on us, that would fall in that category, then it would exclude all of them by definition.

MR. FORGOTSON: What if we have a program that qualifies his total production as being under the ten million thousand cubic feet per year and there is a royalty owner under

one of those contracts where the contract itself is exempt?

MR. GILMORE: That is the question I just posed.

MR. FORGOTSON: You weren't responsive. The question is: would they not be exempt under those circumstances?

MR. McCORKLE: The situation you are assuming is

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that the royalty owner is a fee mineral owner and gives somebody a lease, and thus, as a consequence, he remains nothing but a royalty owner?

MR. FORGOTSON: That is correct.

MR. McCORKLE: I think you will have to define your royalty owner in a different context. Your royalty owner would have to be defined as a man who was a truly non-participating royalty interest under a lease, and of course, it seems to me, that if the exemption was–in other words, if this rule making would not apply to royalty owners, if royalty owners could not claim a small producer exemption by virtue of the definition in this rule making, then they would not be excluded.

MR. FORGOTSON: Even if a person with executory interests were exempted?

MR. McCORKLE: That would be my understanding.

MR. SOLOMON: Would that not make the already discrimination problem even more discriminatory?

MR. McCORKLE: I think you are right. Certainly Opinion 562 found royalty owners were subject to Commission jurisdiction, as I understand it, and they would have a right to claim exemption unless they are excluded, am I right about this, Mr. Gilmore?

MR. SOLOMON: If they are excluded–I am raising a question–some of the larger producers have raised questions, appropriate questions as to discrimination, and I am suggesting

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that we are setting up a new discrimination question.

MR. McCORKLE: I suppose our suggestion related to the object of trying to get some incentive going to get some more gas in the interstate market.

MR. GILMORE: Coming back to the question posed a little earlier, with respect to the appropriate way to handle the sale by one producer to another, in various comments it has been suggested that either the exempt status be denied to those particular sales by one producer to another, or alternatively that the sale by the producer purchaser to a pipeline be also exempt insofar as it relates to the original producer's sales–or if they get the contract differential, which is about the same thing.

MR. BRUCE: The spread be maintained. That was a suggestion in at least three comments that came in, including ours. I did not see any that suggested that this quantity of gas be exempt in the second sale.

MR. GILMORE: No. I twisted it around slightly, but for all practical purposes it is the same thing.

MR. BRUCE: Does the staff have any comment on that suggestion? Have you thought that over?

MR. GILMORE: I am eliciting comments from others. No, I don't have any position.

MR. BRUCE: Now, we are not talking about percentage sales now, we are talking about one producer, say a plant

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operator from a small producer who will be exempt and who then has his rate, whatever that contract may be, then the producer is required to resell at the regulated rate, maybe unaccounted differential there, and our suggestion was that the spread be maintained.

MR. ENDOM: Within limits of resale contract?

MR. BRUCE: Right.

MR. GILMORE: Basically, as I understand it, to give an example of it: if Sun Oil Company sold to Shell, and the contract rate was 14 cents, and let's assume for the moment that–I picked a bad example–assume that Sun was exempt as a small producer sale, then what Shell would want for its reslae of the gas to the pipeline company is its 17 cent contract rate, relating to the gas purchase from Sun. That is the way I understand it, aside from whatever the ceilings were in the particular area involved.

MR. BRUCE: I think we have to assume a couple sets of circumstances. The first is under the resale contract, say Shell sells to Tennessee, that we have that much leeway in that contract to maintain that differential.

The second question is: suppose we don't have that in our contract, and that raises a problem to which I have not addressed myself, and I think Mr. Endom is about to.

MR. ENDOM: Come see us!

(Laughter.)

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MR. BRUCE: I think if we get over that first hurdle, then we can ask ourselves the second question, and maybe you have got the right suggestion to "come see us".

MR. HEADY: I represent Phillips Petroleum Company. For the benefit of the people here, I might state that probably somewhere between 40 and 50 percent of our total jurisdictional sales represent purchases from other producers which we purchase for processing and extraction of various products of natural gas and resale to pipelines.

That processing operation has already been determined by the Commission to be a separate nonjurisdictional business. I think it is apparent, as we have indicated in our comments, that

this proposed rule making as it is presently stated at least would have some rather drastic consequences upon that separate and independent nonjurisdictional business.

And I would like to inquire as to what rationale the Commission proposes in support of the statement that the sales by producers to another producer would be exempt under this proposal, but the resale by the purchasing producer would not?

And, secondly, why should not the resale by the purchasing producer be completely exempt in the same way that the sale to that purchasing producer is exempt?

MR. SOLOMON: Don't you have mostly percentage–

MR. HEADY: We have both.

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A VOICE: Some of them are pretty bad.

MR. GILMORE: I don't really propose to answer your question, but I would like to ask a question of my own.

Of the jurisdictional sales made by Phillips, the 40 to 50 percent you refer to, made as part of plant sales, how much of the gas which Phillips purchases is related to small producer sales?

MR. HEADY: I can't answer that question, because I don't know who would qualify as small producers, but without question it would be a very substantial part. I can't tell you in terms of quantity, because I don't know which producers would be entitled to qualify. But we do purchase substantial volumes of gas from numerous producers, that I would expect to qualify as small producers.

MR. GILMORE: Could you roughly estimate the percentage?

MR. HEADY: I wouldn't have any idea, other than to say that it is substantial. But I don't know. It seems to us that this entire proposal is slanted in such a way as to virtually drive us out of the processing business.

For example, my reason for asking the question a moment ago as to whether a percentage sale would be included in the total of ten million simply illustrates the point that why should a producer make a percentage sale to another producer, and thereby use up part of his limited exemption total

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sale.

The producer would bend over backwards not to make such a sale, because if he does that, he is making a sale which is still subject to regulation, but he is eating into the volume which he could otherwise sell completely exempt.

Our position, as we have stated in our comments, is that the proposal as it is presently stated is invalid and discriminatory on that basis, and my reason in asking what the rationale for that approach is is simply to point out that unless we know what that rationale is, we don't know what it is we are supposed to meet, we don't know what the position of the Government is, and we don't think that this proposed rule making could be valid unless that rationale is stated ahead of time, and we have an opportunity to meet it.

MR. SOLOMON: Meet it when?

MR. HEADY: At some point prior to the time that it is adopted. We don't know why the Commission is undertaking what we consider to be invidious discrimination against us.

MR. FLANINGAM: I would like to ask a question.

My name is Faningam, and I represent Consolidated Gas Supply Corporation. Since this notice was published, the Commission has issued order 411 and R-371, which did exempt producers, but did hold area rates as the ceiling.

In our comments we have suggested that that should be done. May I inquire whether or not the discussion today

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shouldn't be conducted on the premise that the Commission in order 411 has set the course and that any exemption which

might be granted will not relieve these people from observing the area rate ceilings?

MR. SOLOMON: How does that differ from small producer certificates they presently can get?

MR. FLANINGAM: I thought we ought to discuss this in light of that order, because it seems to me that indicates a policy decision, which I would assume would govern here.

MR. SOLOMON: I am not arguing with you, if you exempt the small producers from everything in the area ceiling, whatever it is, what are you exempting them from?

MR. FLANINGAM: From a lot of paper work.

MR. SOLOMON: Of course I think this makes considerable sense. I think that when you set up your system, or as you set up your system, a considerable amount can be said for expanding the small producer's procedural exemptions to the large producers as well.

I don't see any reason why our friends from Phillips should go through a lot of unnecessary paper work if they are willing to live within ceilings, anymore than smaller people.

As a matter of fact, I expect it would cost the consumers a lot more for Phillips to go through unnecessary paper work than a lot of the smaller people. As far as the

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procedure of the small producer, it would seem to me at some time, if and when you get established, that it would make a lot of sense to have consideration to expand it to all producers.

MR. FLANINGAM: If you were to do that, you would want a little more in the annual report form, would you not?

MR. SOLOMON: Maybe, but if they are willing to live within whatever ceilings are applicable, then I don't see why you couldn't allow Phillips Petroleum Company to do so with-

out filing applications, just like Joe Blow Petroleum Company.

MR. FLANINGAM: I think it makes a lot of sense.

MR. FURMAN: I am Jack Furman. I find myself more or less in agreement with these two gentlemen, because Kansas-Nebraska's position is that over 50 percent of its wellhead purchases come from producers that would be exempted by this proposal. We are very much in favor of procedural simplification and exemption. But we would be in a very uncomfortable position if the affect was to take them out from under area price ceilings.

I think that if the Commission is not going to go in the direction of complete exemption, eliminating producer regulations, that the easing of the procedural burdens on the small producers is really the main thing they ought to be striving for here.

If it is helpful, I have put together some figures

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based on 1968 data that shows Kansas-Nebraska purchases from small producers. I would be happy to offer it to the staff for inclusion in the record.

MR. GILMORE: You may certainly put it in the record. Give it to the Reporter.

(The document referred to follows:)

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## KANSAS-NEBRASKA NATURAL GAS COMPANY, INC.
Gas Purchases (Accounts 800, 801, 802, 803, 804, 805)
Year Ending December 31, 1968

## PURCHASES FROM SMALL PRODUCERS

| | Gas Purchases Mcf of Gas 14, 73 # psia 60°F | | |
|---|---|---|---|
| | Total | From Small Producers | % of Total |
| TOTAL GAS PURCHASES | 78,993,429 | | |
| Less Transmission Line Purchases (from interstate pipelines) | 9,703,166 | | |
| | 69,290,263 | | |
| WELL HEAD PURCHASES | 53,853,577 | | |
| Less affiliated companies | 160,988 | | |
| | 53,692,589 | 29,129,478 | 54.3% |
| FIELD PURCHASES | 10,098,734 | 122,622 | 1.2% |
| GASOLINE PLANT OUTLET PURCHASES | 5,337,952 | | |
| Less Affiliated company | 275,607 | | |
| | 5,062,345 | 323,458 | 6.4% |
| TOTAL | 68,853,668 | 29,575,558 | 43.0% |

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MR. KAUFFELT: My name is Kauffelt.

Is it logical–I am asking for comments–is it logical to exempt or not exempt the area price ceiling and leave no protection for small producers as far as the perhaps unreasonable minimums or unreasonably low prices are concerned?

MR. GILMORE: If a small producer has a Sierra-type problem, then maybe the answer for him is not to seek exemption.

MR. KAUFFELT: Has anybody advocated that be changed or there will always be applications for exemption?

MR. GILMORE: I haven't even heard this problem discussed in connection with this.

MR. SOLOMON: The notice of proposed rule making talks a lot about the small producer and certificate procedure that had been in effect for the last year or so having been burdensome. I was thinking of asking the staff to explain what that burden is. I suspect you will not answer me. Therefore, I would suggest that to the extent there has been a burden on the small producers, the burden has been created by exactly the type of problem that you have just been discussing with the gentleman, i.e., interim problem of the small producers, particularly in Permian, where most of it came up, who were interested in taking advantage of the small producer certificate, at the same time while the case was on appeal, and other people could temporarily collect higher amounts on the hope that they would win the case, didn't want to be cut

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out from that. And there was an awful lot of paper work by small producers, trying to for perfectly legitimate reason, to carry the water on both shoulders while these appeals were going on. I don't know–I haven't been in this game in the last year or so–but there may be a similar problem with all the maneuvering that is going on in area prices now.

My suggestion is that these burdens that the notice talks about, the burdensomeness of the small producer's certificate, is a temporary problem rather than a permanent problem, and once the–if we ever reach that happy day when we know what

is going on in our pricing and what have you, there won't be any real burden on this small producer certificate at all.

MR. GILMORE: Of course, the question is: when do we hit this happy day?

MR. SOLOMON: Until you do, they are still going to carry the water on both shoulders, and they should. I mean, they have to protect themselves from whatever may happen in a flexible situation.

MR. GILMORE: They are simply doing the same thing that the large producers are doing.

MR. SOLOMON: I am not making any invidious statements. If I were representing a small producer, obviously I would want to get the best of both worlds and work out ways of doing it.

MR. HEADY: I am not sure Mr. Solomon and I are

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talking about the same proposed rule making, because the proposed rule making would exempt the small producers not only from filing requirements but also from rate restrictions. Mr. Solomon seems to be talking about a proposed rule making which would exempt the small producers only from filing requirements.

MR. SOLOMON: I am aware of what rule making does. I was directing myself to one of the alleged justifications for the proposed rule making.

MR. HEADY: My question is this: is it the position of the New York Commission that the exemption of small producers should be limited to the exemption from filing requirements and not exempted from rate restrictions?

MR. SOLOMON: I would think so. Tentatively I would think that is right.

MR. FLANINGAM: That was the position I stated a minute ago. I thought that in view of the Commission's Order 411 we should discuss that matter in this light.

MR. SOLOMON: What is 411?

MR. GILMORE: Appalachian.

MR. FLANINGAM: In that they did exempt small producers, but did make the area rate ceilings applicable. If you

wanted to exceed it, the small producer is required to file a petition for relief.

MR. McCORKLE: Let me ask you: if the Commission

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should include that there is serious question as to the legality and its authority to carry out what it has proposed in this rule making, for example, then wouldn't we have to fall back, in effect, to Mr. Solomon's position of what can the Commission do lawfully that would achieve your desired objective? And that is, accord as much relief as possible to the small producers, giving consideration to the exigencies of their problems as they arise in area rate making and so on?

MR. GILMORE: That is what has been suggested by Consolidated in the comments which it filed in this proceedings.

MR. McCORKLE: That is why I wanted to be sure I understood.

MR. SOLOMON: We would hope there would not be merely a determination based upon what your power is, but also what makes sense.

MR. HEADY: Let me ask what may be an embarrassing question: the Commission in its notice, it seems to me, goes both ways at the same time. On the one hand it says that the small producers probably cannot realistically expect to receive higher prices than the larger producers, yet at the same time the purpose of the exemption is to encourage further exploration by small producers.

My question, which may or may not be embarrassing, is: to what extent do the pipelines contemplate that they would actually pay above-ceiling prices to small producers?

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MR. McCORKLE: Are you suggesting a situation where you might have under an operating agreement where a large producer has a certificate which covers a non-operator small-producer sale and that small producer gets an exemption? Immediately then he is out from any limitations insofar as rate is concerned, and the next day he makes a demand upon the pipeline to pay him a just and reasonable rate of thirty-five cents?

MR. ENDOM: I don't know that that would qualify as reasonable.

MR. McCORKLE: After ten years of trying to get a little justice, I have got a right to use a little license.

Would you agree with that, Mr. Solomon?

MR. HEADY: My question is really intended to be a practical one, in the sense that if the pipelines will not pay more to the small producer than they will to the large producer, then all we are talking about in practicality is exemption from filing requirements. We don't even need to talk about exemption from rate restriction.

On the other hand, if the pipeline contemplates that they will, in a substantial number of instances, be willing to pay more to the small producer than they are willing to pay to the large producers, then we do have a number of very serious problems as to the validity of the proposed regulation, at least in its present form.

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MR. ENDOM: If we were willing to pay a large producer thirty-five cents, and we were willing to pay a small producer thirty-five cents, the problem is, a small producer, I think, would probably (inaudible) that would be contract price, because of limitation on large producer and regulatory (inaudible), he would not be able to collect it. It is not so much a matter of willingness, but a matter of ability to collect.

MR. HEADY: It applis to new contracting as well.

MR. ENDOM: Yes.

MR. HEADY: You have two instances. On the one hand you have a small producer who is presently restricted to a ceiling rate below his contract. Once that exemption is granted, he is immediately entitled to collect his contract price under existing contract. You have another situation in which the pipelines might or might not be willing to pay to a small producer for a new sale a price which is above the ceiling which is applicable to the large producer.

I come back to the point: I don't know what we are dealing with from a factual standpoint, except that on the basis of the Commission's proposed rule making I have to assume that there would be a substantial number of instances in which

pipelines would pay to the small producer a price higher than the ceiling applicable to the large producr.

On that basis, I think we have to face up to the question of validity of the proposed regulation.

[T-34]

MR. McCORKLE: Or negotiate new contracts with a small producer at a higher rate in the contract than they were permitted to do under area rate regulation with those producers who are–

MR. HEADY (interposing): That is another point.

And another point would be whether any type of contractual escalation provisions, which are prohibited to large producers, would be permissible to small producers.

MR. FORGOTSON: Isn't my understanding of the regulation–I had difficulty with the same point–that if a person qualifies for small-producer certificate, they are exempted from everything, procedurally and substantively as far as pricing, as far as everything else–that is my reading of the proposed rule making. And that would exempt them from area ceilings, that would exempt them from getting new contracts and that would exempt royalty owners so they could take their quantity, and it seems to me terrifically terrible feasibility and accounting problems–it would create problems that the gentleman from Phillips talked about. I am not sure, by the way, even if the exemption were granted that pipelines would pay these higher prices, unless of course commanded a considerable reserve. Because I think there would be accounting problems from the pipeline standpoint, too.

MR. HEADY: Let me make one more comment, which is in a sense a repetition of what we stated in our filed comments.

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That is, it seems to me that in large measure we are focusing on the wrong question. That is, if the prices are too low for the small producer to encourage him to engage in exploration, they are likewise too low for the large producer.

The problem and the solution are not in the differences between the small producer and the large producer, but in the

level of rates which are available to everybody. If the rates are too low to encourage exploration, we are not going to solve that problem by talking about distinctions between small producers and large producers.

The real solution there is to get some realistic rates which are applicable to everybody.

MR. McCORKLE: Amen.

MR. ENDOM: Tennessee supports the Phillips statement.

MR. FORGOTSON: So do we.

MR. GILMORE: Does anyone have any further comments they wish to make?

MR. POWELL: My name is William Powell.

My question is: A producer has less than ten billion production under the contract, but three or four years later he finds under the terms of the contract they take fourteen billion.

How much or is all of that fourteen billion exempt?

MR. GILMORE: You are talking about a single contract?

MR. POWELL: Right.

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MR. GILMORE: All of it is exempt.

MR. POWELL: Even if you go above ten billion.

Thank you.

A VOICE: Did you say they were exempt?

MR. GILMORE: They were exempt as to that particular sale. Any future sale made–

MR. McCORKLE (interposing): Suppose he has two or three other contracts that run him over the ten billion–as I understand the question, at the time he sought an exemption he was under ten billion. But as a consequence of subsequent development on the leases covered by that contract, the volumes went very substantially higher, and I understood Mr. Gilmore to say he is exempt.

My question is: suppose at the time he sought that exemption, you put it on a contract basis is what is disturbing me, and suppose at that time the small producer who is seeking exemption has several other contracts, and in the aggregate they

exceed ten billion, he could not get exemption; is that right?

MR. SOLOMON: He has got exemption. Start out that he has one. The question is, what happens to it?

I think, the way this rule is written—and correct me if I am wrong—that he can, once he has got an exemption, and if he makes a new contract which he knows is going to take him over the thing, he can still do it and keep his exemption

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until he makes his next report. Isn't that the way it actually works?

MR. GILMORE: That is right.

MR. HEADY: The way I interpret this statement on Page 3, the answer to Mr. Powell's question is that whenever he goes over ten million total for any reason, he automatically loses his exemption.

MR. McCORKLE: That is the question I was trying to raise and didn't do it, apparently.

MR. HEADY: "The exemption so ordered would continue as long as the small producer's jurisdictional sales do not exceed ten million MCF in a calendar year when aggregated with all jurisdictional sales of affiliates as hereinafter defined."

MR. SOLOMON: When you get into the procedure of working this out, going to make the annual report, nobody is going to even know they exist. I see your ambiguity, but as a practical matter, the Commission is not going to know they exist until they make the annual report.

MR. HEADY: I am not questioning so much the point that you wait until the end of the year. I am questioning the fact that if you started out with a sale which was less than ten million, and under that sale you sell more than ten million, I think at the end of that year the producer would be required to report that he is no longer exempt.

MR. SOLOMON: Frank says that nonexemption would only

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apply to future sales.

MR. McKINNEY: The way to rule is written in Paragraph (c), "Duration of the Exemption," it is within the discretion of

the Commission to terminate the exemption when the small producer no longer qualifies. But even if the Commission were to exercise that discretion and terminate the exemption, nonetheless, as I read the last sentence of the paragraph on top of Page 9, the exemption as it applied to the sales up to ten million would still be effective.

MR. SOLOMON: Under a contract dated prior to the termination; yes.

MR. GILMORE: The question was related simply if he had one contract, and he got his exemption, and two or three years later he was making a sale for more than ten million, whether the exemption would still apply to that particular contract; and the answer was yes. It is only future contracts that would be adversely affected.

MR. HEADY: What if that one contract goes over ten million limit?

MR. GILMORE: Once he gets his exemption, he retains it, after those contracts covered by the exemption.

MR. McKINNEY: I think the thing about it is that the Commission on its own motion or on application terminates such certificate. It appears to leave it within the discretion of the Commission to terminate small-producer certificate. It

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seems to me a better rule would read that the exemption no longer exists; that is, if you are going to have a rule at all.

MR. SOLOMON: We are going to have to have some mechanics.

MR. EHRENKRANZ: Wouldn't the answer to the question be on Page 3 where it says: "Should a producer cease to qualify as a small producer, it would be required to file separate certificate applications and individual rate schedules for future sales, but the exemption previously granted would remain in effect for sales made under contracts dated prior to such termination."

MR. GILMORE: Yes; that is the same way the Permian small producer certificates have worked.

MR. SOLOMON: As long as small producer certificate is subject to the area ceiling, it doesn't really make any difference

as to whether they actually are twice as big as small producer certificate.

MR. EHRENKRANZ: This contemplates they wouldn't be subject to area ceiling.

MR. SOLOMON: That is different.

MR. GILMORE: My reference to the "sameness" was specifically to the problem being discussed.

MR. EHRENKRANZ: I think Mr. Powell's question went to the matter of, without respect to sales previously covered, so if volume ballooned above ten million, it would still be

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covered.

MR. HEADY: Let me ask another embarrassing question.

If the producer, by making these additional contracts, tends to lose his exemption, how does that encourage him to further exploration?

MR. HARKOWAY: Wouldn't that encourage the producer to further exploration to sell into intrastate market and not to the interstate market, where he would then lose his exemption?

MR. GILMORE: A lot depends on what the rates are in respective markets, I assume. He would sell where he could get more money, I would think.

MR. FORGOTSON: I think this gets back to the question raised on our original comments, and that is, what good is this really going to do? Where is the incentive toward further exploration and deliverability of more gas in interstate sales going to come from out of this exemption, and isn't this more—if you will pardon me—of a farcical procedure?

First, because I am not sure that pipelines would pay higher price, and there is the question of whether the exemption would apply anything to the procedural burdens.

Why go through this whole exercise and not come to the real problem, which is a price structure for large and small producers, that is going to encourage exploration and development and protection for sale and resale?

[T-41]

MR. POWELL: I can't speak for the large producers, but I can tell you this: if this ten billion can go to 14 billion and still be exempt–

MR. FORGOTSON: Only for one year.

MR. POWELL: It is from then on.

MR. HEADY: That is one more point, in which the producer is encouraged not to sell to the processing producer, but is encouraged to sell to the pipeline, one more point of discrimination.

MR. BLICKMAN: My name is Blickman. I'm from the Office of Economics.

I would suggest that we differentiate among the different types of markets.

For example, in the Appalachia and Illinois Basin, approximately 98 percent of the rate schedules are filed by small producers. I think the figures are given in the Appalachian-Illinois rate order, and certainly you can't deny that it would be very effective in those marginal areas where you have a preponderance of producers which would qualify under this exemption.

The question is whether we should dismiss the exemption rule making as a whole or whether we should accept it, for those areas where it may be potentially effective.

MR. SOLOMON: If the Commission thought that decision was worth anything–the Appalachian case–this

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rule making, if I understand it, is a rule to upset the order the Commission just issued.

MR. FLANINGAM: If they adopt the rule as proposed here, they would nullify Order 411.

MR. POWELL: A lot of other decisions are made on price.

MR. SOLOMON: Not quite as recent.

MR. POWELL: Still not in being–the Commission is going to follow their policies up until the time they change them. If they change this and adopt them, there is going to be an awful lot of contracts and area rates to be affected all across the board.

MR. SOLOMON: If the New York Commission here today seems to be asking a lot of the same questions that the major producers are asking, and we think they exist, I don't want to be taken as indicating that we think that granting this exemption would have no effect. We are inclined to believe in certain areas it would have serious adverse effect in certain areas.

MR. HEADY: If you postulate a situation of an area in which there is a predominance of small producers, and the theory is that the exemption would encourage exploration by small producers in that area, why not encourage exploration by larger producers also? Why not exempt everybody in that area?

MR. SOLOMON: Ken, the original proposal for

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Appalachia specifically asks for comments on exactly that, as to whether or not the best way of regulating in that area was to not regulate, and presumably the Commission considered that and they have come out with a decision. But your question was raised in that very rule-making procedure.

MR. HEADY: It was not raised in the context of exempting part of the producers and exempting all of them–

MR. BLICKMAN: I would like to answer Mr. Heady.

There is a certain fallacy and logic, and I don't remember the name at this point, but it goes this way:

If a small dose of morphine will relieve pain, why not have a massive dose and relieve the patient of pain for all time? You have to concentrate on the nature of the market structure, on the nature of the supply function in natural gas. I think if you understand the manner in which the small producer complements the large producer, you can validly establish a distinction between the two, which would support this rule making. And as far as I recall in many of the responses, it was emphasized that the small producer does not have any independent price making function, but is rather sheltered under the joint arrangement with the large producer who operates in the nature of a price determiner.

MR. HEADY: What is going to encourage the large producer to continue to explore in this area that you are talking about?

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MR. BLICKMAN: I will not attempt to preempt the function of this Commission. I feel much too modest in that respect. I am sure something will emerge, and I prefer to let the matter rest there.

MR. GILMORE: Could I throw one proposal up, either that we take a ten-minute recess, if it is contemplated that the discussion will be on for a while, or is it contemplated that the discussion is close to termination?

A VOICE: Let's try to finish.

MR. McKINNEY: In reference to the gentleman from the Office of Economics, his comments on selective exemption here. I think the Commission pointed out in its Order on Page 2 that impact on the consumer of exempting small producers from regulation should thus be minimal.

All the other questions and legal questions of discrimination aside, it seems to me that if this rule making were to take on any legality at all, that at the very least the sales by the small producers to other producers, primarily those sales occur in processing-plant operations, and I am here today speaking for Signal Oil & Gas Company, and they have substantial processing-plant operations, just not as big as Phillips, but like Phillips, that at the very least that you have to also exempt the sale by the processing-plant operator on those volumes that are sold him by the small producer which are exempt.

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Now, if those volumes are minimal in their impact on the consumer, if they are sold directly to the pipeline, they are just as minimal if the processing-plant operator is allowed to sell on an exempt basis also. So there can't be any impact on the consumer if the Commission's statement is true here as far as small producers themselves are concerned.

By the same token, you are alleviating at least one problem, a very formidable problem for processing plant operators, and you are permitting the use in the same facilities, the gathering facilities, the processing-plant facilities at lesser cost, I might add, to the consumer, by exempting the sale by the processing-plant operator. So I think if this rule making is to take on any validity at all, if the Commission intends to go on

and act on it, that at the very least they do have to exempt the volume of sales that are made by the small producer to other producers. If it is minimal in one instance, it is just as minimal when it is sold by the second producer.

MR. GILMORE: Jim, how much gas does Skelly purchase from small producers–Signal; excuse me.

MR. McKINNEY: We tried to determine that before we met here today.

First of all, let me say that 99 percent-plus of the gas Signal sells from its processing plant is purchased from other producers. They have very, very little production of

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their own. Almost 100 percent is purchased from other producers.

Now, I don't want to be held to these figures at all, because this has been a very, very cursory study. We don't know what is going to constitute a small producer and what isn't going to constitute a small producer, but it looks to us like that between 60 and 70 percent of the gas that we sell presently comes from small producers.

I don't have any idea in total volume. There is substantial volume.

MR. HEADY: To give you some illustration along that line, and again I can't be specific in terms of quantity, but we have fairly recently entered into a contract to sell gas to Panhandle Eastern from the Douglas area of Wyoming. I would venture that a very large part of that gas is being purchased from producers who would qualify as small producers under this exemption, because this was an area that was essentially developed for oil production by small producers. I think that under this proposed regulation we would not have been able to go into that area and establish a plant and be able to buy that gas simply because the small producers would not have been willing to sell to us; and I don't think I would have sold to us either under those circumstances.

[T-47]

MR. SOLOMON: Is this oil well gas rather than gas well gas problem?

MR. HEADY: It is both. In large measure, it is casing head, but there is beginning to be some gas well gas developed in the area also. Most of that is brought under percentage type contract, which pay the producer a percentage of the residue proceeds and a portion of the liquids extracted.

MR. SOLOMON: As a practical matter, you people are performing the gathering function for the pipeline, aren't you?

MR. HEADY: In this particular instance the pipeline installed the gathering system, and we are paying them for the use of that pipeline system, but we are performing the purchasing activities and a part of the gathering actities, the connection of individual wells, for the pipeline companies, yes.

MR. SOLOMON: In my period of time on the Commission Phillips had some gathering lines which were fairly extensive.

(Discussion off the record.)

MR. HEADY: If the producer, by making a percentage sale to us, would be eating into his ten million exemption, he would simply be precluding himself from making further exemption sales down the line. There wouldn't be any logic in his entering into percentage sale contract with another producer under those circumstances.

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On the other hand, the pipeline could go in and buy him everything.

I would like to say that we made the comment in our filing that frankly we think that this proposal would be the greatest incentive to intrastate sales since the opinion of 1968. Once the producer approaches his ten million limit, he has no further interest in making any interstate sale. His interest in interstate sales is terminated as of that point. He is doing his exploration for intrastate.

MR. GILMORE: Are there any further comments on any of the issues posed in this proceeding?

MR. ENDOM: There are a lot of issues, as I said before, that are not being discussed. We are not precluded because of later developments on things that you cannot see now, because of our failure to comment–

MR. GILMORE (interposing): No.

MR. SOLOMON: If you are going to close off, I would second a suggestion that was made earlier that if the Commission does wish to proceed with this docket, it would be most useful to the Commission—my guess as well as everybody else—before the final rule was put out, in light of these comments and written comments, to have a new notice—

MR. HEADY: I have one other question that has occurred to me. It relates to the question of the extention of the exemption to present certificate and rate procedures.

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I can't give you specific instances, but I am sure that we have some of the situations in which we are purchasing gas from a small producer who could qualify under this exemption.

Our sale is being made at a price increase which has been suspended and is subject to possible refund. The producer is not selling to us under a percentage contract, but selling to us under a contract in which he has his own rate schedule and has made his own rate filing.

Would it be contemplated that that producer, when he became exempted under this proposal would be exempted from any refund obligations under his contract?

MR. GILMORE: For the period prior to his exemption?

MR. HEADY: Yes.

MR. GILMORE: The Commission, in its notice, simply threw that question up for grabs and asked for comments.

MR. HEADY: Let me extent my question a bit further. Our experience on this refund question is that a number of parties to various rate proceedings have taken the position that the producer obligations to refund is to refund every thing which he may have collected over the ceiling price, over the ultimately determined just and reasonable rate, regardless of what the consequences of that refund may be.

For example, in our own rate case a number of years back, although the Commission found that our costs substantially exceeded our total revenues, there are a number of parties—

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Wisconsin, California, I think even the New York Commission contended that we had an obligation to refund over what the Examiner there determined to be the just and reasonable levels, even though that would simply bring about a further deficit in our total revenue.

And I can visualize a situation here in which a small producer might be relieved from his obligation to refund either retroactively or forward from the date, but our obligation to refund comes about at some later date, and the contention would be made that Phillips had to refund over this whatever level was determined, whether or not we got any refund from a small producer, and it certainly seems to me that that certainly puts us in a rather unique position as well and I am sure we have that type of situation.

MR. GILMORE: I would be surprised if you didn't.

MR. HEADY: We have had singularly lack of success in generating any sympathy of what can visualize they are going into the consequences of a particular refund may be upon us, and I can visualize they are going into the same problem here.

MR. GILMORE: Are there any further comments?

MR. ENDOM: Will a day be fixed to show transcript corrections?

MR. GILMORE: Let me suggest that anybody who wishes to make transcript corrections make them prior to Christmas.

(Discussion off the record.)

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MR. GILMORE: If there are no further comments, I suggest we adjourn.

(Whereupon, at 11:35 o'clock, a.m., the conference was concluded.)

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR 154.91, 154.104, 154.110, 157.40, 250.10, 250.11]

Before Commissioners: John N. Nassikas, Chairman;
Lawrence J. O'Connor, Jr.,
John A. Carver, Jr., and
Albert B. Brooke, Jr.

Exemption of Small Producers ) Docket No. R-393
From Regulation )

ORDER NO. 428

ORDER ESTABLISHING BLANKET CERTIFICATE PROCEDURE FOR SMALL PRODUCER SALES AND PROVIDING RELIEF FROM DETAILED FILING REQUIREMENTS

(Issued March 18, 1971)

The Commission on July 23, 1970 issued a notice of proposed rulemaking in this proceeding (35 F.R. 12220, July 30, 1970) proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers as defined therein. The proposal did not cover either percentages sales made by small producers pursuant to percentage sales contracts or sales to interstate pipeline companies by their affiliates.

In response to the notice comments were filed by seventy three parties, including producers, pipeline and distribution companies, associations representing producer and distributor interests, and the California and New York State Commissions. A conference was also held in this case on December 8, 1970. The small producers support the exemption as originally proposed, while the large producers either oppose such exemption or question its advisability. Pipeline and distribution companies are divided on the issue, with one expressing outright opposition and some of the others suggest-

ing extensive modifications. The American Public Gas Association and the California and New York State Commissions also oppose the proposal.

The small producers argue that traditionally they have been very aggressive in searching for new gas reserves but that such activity has been greatly curtailed in recent years, largely because of restrictive regulation. They further state that their drilling efforts often prove or disprove the presence of gas bearing structures, and that the information gained is useful to all producers, large and small, in their search for new gas supplies. Because of uncertainties in regulated prices, they claim that discontinuation of regulation, rather than higher ceiling prices alone, is necessary to provide the incentive required to encourage a substantial increase in exploratory drilling.

Opponents of the proposed exemption, on the other hand, contend that the proposal will lead to higher natural gas prices for small producer sales resulting ultimately in higher consumer rates. They also disagree with the view that the impact on the consumer will be minimal. In addition, they question the Commission's authority to exempt small producers.

We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no room for administrative judgment and discretion. Mr. Justice Clark, speaking for the Court in *F.P.C.* v. *Hunt*, 376 U.S. 515 (1964) recommended that the Commission consider procedures for the exemption of small producers. And, in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Court, while recognizing that the language of Sections 5 and 7 is without exception or qualification, noted the power of the Commission under Section 16, for purposes of its rules and regulations, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

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One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By our action herein, we are taking an important step forward to meet this responsibility. Upon review of the contentions made by the various parties, we have decided that both existing and future sales of small producers shall be regulated in the manner hereinafter provided.

Such action should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas. Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the administrative burdens connected with processing small producer filings.

We have reviewed the impact of our action on 96 pipelines that purchase gas, based on 1969 statistics in Forms 2 and 2-A. This shows, for example, that Kansas-Nebraska's purchases from small producers amount to 21.63% of its total gas supply including purchases from all producers, pipelines and its own production. Comparable percentages for many of the small gather-type pipelines were quite high. However, many of the major pipelines show less than 10%. Others show no purchases at all from small producers. The overall weighted average for the 96 companies was 7.54% (or 10.52% after eliminating all pipeline to pipeline sales).[1]

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[1]These statistics do not include resales to pipelines by large producers of gas purchased from small producers.

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The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers sales. We shall also provide certain other safeguards against unreasonably high small producer prices, as hereinafter discussed, to assure adequate protection for the consumer.

We are concerned that favored nation, price redetermination and spiral escalation provisions in small producer contracts may have an adverse impact on consumers. The filing of contracts containing such clauses executed on or after April 2, 1962, has previously been proscribed by the Commission as contrary to the public interest.[2] There is, of course, no objection to the use of these provisions to the extent the resulting rate does not exceed the applicable area just and reasonable rate ceiling, as provided in our *Permian* opinion, 34 FPC 159, 236, or, where none is available, the applicable area guideline initial rate ceiling. But these provisions should not be permitted to increase the contract price above such level. To do otherwise would clearly be contrary to the public interest. Consequently, this order will limit the use of these indefinite price escalation provisions by small producers.

The New York Commission contends that the proposed exemption may open the way for large producers to sell their gas in interstate commerce free from Commission regulation by selling their reserves in place to small producers, who would in turn resell the reserves under a conventional (exempt) sales contract to an interstate pipeline. To forestall this possibility, we shall provide that the exemption authorized here for small producers shall not apply to jurisdictional sales made by them where the gas reserves relating thereto were acquired by the

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[2]Order No. 242, 27 FPC 339; *F.P.C.* v. *Texaco Inc.*, 377 U.S. 33.

purchase of developed reserves in place from a large producer. In such circumstances the small producer will be required to obtain separate certificate authorization.

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Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee) in its comments inquired as to whether a pipeline will be assured of recouping its cost of purchased gas if it pays the "going" field price to a small producer. Any question as to the propriety of the price paid by a pipeline to a small producer will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified. The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent. We shall also require pipeline purchasers to file, within 60 days of the execution thereof, every new contract or contract amendment for the purchase of natural gas from a small producer whose sale is regulated by the terms of this order.

The exemption proposed in the July 23 notice was applicable, *inter alia,* to sales made by a small producer to a large producer, but not to the resale of such gas by the large producer. A number of large producers argue that if sales by small producers to them are regulated by this order, there is no justification for not also applying consistent treatment to the resale of such gas. They warn that if large producers in these circumstances are not exempt they will be forced to sell gas purchased from small producers under new contracts in intrastate commerce in the future or to forego such small producer supplies, thus limiting the usefulness of their existing gathering and plant facilities. They also point out that if these small producer sales are made directly to an interstate pipeline purchaser under new contracts, it will be necessary for the purchaser to construct new facilities to take such gas which would duplicate existing facilities of large producers. With

regard to existing sales, they claim that it would be discriminatory to prevent large producers from increasing their resale rates to account for higher rates paid to small producers.

We think it important to encourage large producers to continue to utilize their existing facilities for the resale in interstate commerce of gas purchased from small producers.

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For this reason we shall permit large producers with respect to the resale of gas sold to them by small producers pursuant to the subject exemption to file rate increases authorized by contract, thus permitting them to maintain the contract price differential between their purchase and resale prices. These filings shall be accepted, without refund obligation, as long as the price differential is consistent with prevailing price differentials in the area and as long as the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for by large producers or the prevailing market price for intrastate sales in the same producing area. We shall require large producer purchasers, like pipeline purchasers, to file any new contracts or contract amendments with small producers.

Some of the large producers contend that royalty interests should be excluded specifically from any exemption granted to small producers.[3] We disagree. The royalty interests stand in the same shoes as the working interest owners. Consequently, if a royalty interest relates to a small producer sale, such interest shall be exempt, but if it applies to any other sale it will not be exempt.

Consolidated Gas Supply Corporation (Consolidated) urges that small producers be exempt from compliance with Section

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[3]The question of this Commission's jurisdiction over royalty interests is now pending before the United States Court of Appeals for the District of Columbia in *Mobil Oil Corporation, et al.* v. *F.P.C.*, Nos. 23463, *et al.*

7(b) with respect to the abandonment of their small producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment. Consolidated points out that the vast majority of these are routine matters occurring either because of depletion of production or because continuance of the sale is uneconomic, and in these situations the purchaser routinely consents to the abandonment. But, Consolidated claims that in the rare situation where there is a dispute as to whether a small producer sale should be discontinued there should be some Commission procedure available for the resolution of such dispute.

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We think it important to retain control over all abandonments of jurisdictional sales. For this reason, small producers shall be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein.[4] We shall also require purchasers to notify us of the cessation of deliveries by a small producer regulated by the terms of this order within 60 days of such cessation.

Austral Oil Company Incorporated (Austral) suggests that the definition of "affiliated producers" be clarified to make it clear that such term does not include small producers who have participated in joint ventures, nominee agreements and similar contractual arrangements in order to spread the risk of exploration and development and for operating convenience, unless such agreements otherwise establish the power to direct or cause the direction of the management policy of a person. The suggestion is a good one and we shall adopt it.

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[4]If a contract for an exempted sale of gas expires and is not extended or replaced by a new contract, the small producer must continue the sale of such gas unless the pipeline consents to abandonment or the producer obtains abandonment authorization. Moreover, in such circumstances the small producer is not entitled to collect any rate in excess of the highest rate permitted under the expired contract for the sale of such gas unless it files a notice of change in rate in accordance with Section 4(d) of the Act.

Tennessee has raised a question as to the applicability of the small producer exemption to a sale by a non-signatory small producer under a large producer's rate schedule. The exemption is applicable to such sale by a small producer.

The Commission proposed in the July 23 notice to waive the provisions of Section 154.63 of the Commission's Regulations to permit the tracking by pipeline purchasers of rate increases resulting from the exemption of small producers

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in those situations where a purchaser did not otherwise have the right to make a tracking filing. Consolidated claims that the collection of a tracking increase by a pipeline should not be subject to reduction and refund, as provided in the July 23 notice, inasmuch as the small producers will have no potential refund obligation with respect to their increased rates.

Small producers will have no refund obligations with respect to increased rates, if any, collected for sales regulated hereunder to pipelines, and, as a result, pipelines will receive no refunds from small producers to flow through. However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in (1) a pipeline rate case or (2) a proceeding involving only the tracking increase. Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. The Commission shall consider all relevant factors. See *Permian Basin Area Rate Cases,* 390 U.S.

747 (1968); *Austral Oil Co.* v. *F.P.C.*,__F. 2d__(Fifth Circuit 1970, slip opinion dated March 19, 1970, No. 27492, et al.) In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests.

Sales from small producers to large producers will likewise carry no refund obligations. However, if the resales by large producers to pipelines reflect new small producer sales at prices in excess of the previously discussed standard, the large producers' rates will be subject to suspension and refund.

Accordingly, the provisions of Section 154.63 are hereby waived to permit pipeline purchasers or pipelines purchasing from such pipeline purchasers to file rate increase applications to track small producer rate increases resulting from the exemption of small producers pursuant to the provisions

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of this order, provided that pipelines filing such an adjustment submit supporting schedules showing the computation and provided further that such filing may be made only if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or orders, affect the pipeline's average cost of purchased gas by one mill or more. The Commission reserves the right to require a pipeline to file all information required by Section 154.63 if it deems such information to be necessary.

Many of the small producers urge us to relieve them of any potential refund obligations they have under increased rates collected in Section 4(e) rate suspension proceedings or under initial rates collected under temporary certificates issued pursuant to Section 7. These matters more properly should be disposed of in appropriate area proceedings after the refund obligations are determined.

In view of the foregoing, we shall revise Section 157.40 so as to establish a blanket certificate procedure for small producers,

applicable to all small producer sales made nationwide under existing and future contracts.[5] Small producers under this procedure shall be relieved of all filing requirements under the Natural Gas Act and the Commission's Regulations, except for the annual statement required by Section 154.104 of the Regulations and except for compliance with the aban-

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donment provisions of Section 7(b) of the Act. By subsequent order we shall amend Section 250.11 to provide for a revised annual statement to be filed by small producers regulated hereunder commencing in 1972.

Producers who have received small producer certificates prior to the issuance of this order, or who have applied and qualify but have not yet received such a certificate, will not be required to file new applications seeking exemption, unless otherwise directed. Commission orders relating to those small producers who have applied and qualify for a certificate will be issued without any further action on the part of the producers involved. Such certificates, regardless of the date of issuance, will be effective as of 45 days from the date of issuance of this order. Similarly, all of those small producers who file applications for a blanket certificate within 45 days from the date of issuance of this order and who are entitled to coverage thereunder will also receive certificates which will be effective as of 45 days from the date of issuance of this order, regardless of the date of issuance of such certificate. With regard to those producers who have small producer certificates, the existing certificates, without further order of the Commission, shall be deemed to cover, as of 45 days from the issuance of this order, all small producer sales of those producers which are exempt under the provisions of this order. The 45 day period will give

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[5] Notwithstanding the provisions of this order, a small producer may file for the minimum rate authorized by the Commission for any area.

the pipeline purchasers and their distribution customers time to track any increases resulting from this action.

We intend to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers.

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*The Commission finds:*

(1) The notice and opportunity to participate in this rulemaking proceeding through the submission, in writing, of data, views, comments and suggestions are in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code.

(2) The action taken herein is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modifications adopted herein to the amendments proposed in the notice of this proceeding are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

*The Commission,* acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o, *orders*:

(A) Parts 154 and 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations, are amended as follows:

1. Part 157 is amended by revising Section 157.40 to read:

"§ 157.40 Exemption of small producers from certain filing requirements.

(321)

(a) *Definitions*

(1) A 'Small Producer' is an independent producer of natural gas as defined in § 154.91

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of this chapter, who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of 'affiliated producers' are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year. As used in this section, the term 'jurisdictional sales' includes volumes of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this section has an interest in such sales, but does not include sales made pursuant to percentage sales contracts.

(2) 'Affiliated producers' are persons who, directly or indirectly, control, or are controlled by, or are under common control with, the applicant producer. Such control exists if the producer has the power to direct or cause the direction of, or as a matter of actual practice does direct, the management and policies of another producer, whether such power is exercised alone or through one or more intermediary companies, or pursuant to an agreement, and whether such power or practice is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, relationship of blood or marriage, or any other direct or

indirect means. For the further purposes of this section, the term 'agreement' shall not include any agreement for the operation of a natural gas producing property or a plant processing natural gas or any joint venture, partnership, nominee, or other type of agreement pertaining to the joint exploration for and development and operation of oil and gas properties, unless such agreement otherwise establishes the power of one producer to direct or cause the direction of the management and policy of another producer.

(3) 'Small producer sales' are (i) sales by a small producer of his own interests under his own contracts; (ii) sales of all interests under a small

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producer's contract if producers not qualifying as small producers have interests which in the aggregate are no greater than 12½ percent; and (iii) sales of a small producer's interests under another producer's contract.

(b) *Procedure for securing blanket small producer certificate.*

(1) Small producers may apply for a blanket certificate to cover all existing and all future jurisdictional sales that do not raise the producer's total jurisdictional sales on a nationwide basis above 10,000,000 Mcf during any calendar year. Applications by these producers shall include the following information: (i) total jurisdictional sales on a nationwide basis for the year preceding the application; (ii) a list of outstanding certificates and rate schedules together with names and percentage of interest of other

interest owners under such rate schedules; (iii) a list of outstanding rate schedules of others in which applicant owns an interest together with applicant's percentage of interest; and (iv) the names of all owners (stockholders, partners, joint venturers, etc.) of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company, and any positions such owners may hold with another natural gas company.

(2) An applicant for a blanket certificate who has no outstanding certificate issued by, or rate schedule filed with, this Commission for the sale of natural gas shall include the following information in his application:

(i) a list of all contracts to sell natural gas in interstate commerce,

(ii) source of production, total rate and the annual volume delivery obligations

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of the producer under each such contract, together with names and percentage of interest of other interest owners under each such contract, and

(iii) a list of owners of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company and any position such owners may hold with another natural gas company.

(3) The application shall contain the information required by the form set out in

§250.10 of this chapter. A conformed copy shall be served upon each of the applicant's purchasers.

(c) *Exemption under blanket certificate.* Small producers certificated hereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract. However, no small producer shall be relieved from compliance with Section 7(b) of the Natural Gas Act with respect to any small producer sale exempted hereunder. The exemption authorized herein shall not apply to any jurisdictional sale made by a small producer where the gas reserves relating thereto were acquired by the purchase of developed reserves in place from a large producer.

(d) *Duration of the exemption.* The exemption authorized hereunder shall remain in effect for each small producer until the Commission on its own motion or on application terminates such certificate because the producer no longer qualifies as a small producer or fails to comply with the terms of the exemption. Upon such termination the producer will be required to file separate certificate applications and individual rate schedules for future sales but the exemption will still be effective as to those made under contracts dated prior to such termination.

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(e) *Limitation on contractual provisions.* No Small Producer granted exemption under paragraph (c) above shall charge or collect any rate for a small producer sale of natural gas in excess of the applicable area just and reasonable

base rate ceiling, or, where none is available, the applicable area guideline initial rate ceiling, where the contractual right to such rate is based upon any contractual provision which would not be permitted by subsections (a), (b), (b-1) and (c) of Section 154.93. For the purposes of this limitation, it shall make no difference whether the contract was executed prior to or subsequent to April 3, 1962.

(f) *Filings by large producers with respect to related resales.* A large producer may file for the price specified in its related contract for the resale of any natural gas sold to it by a small producer pursuant to the exemption authorized hereunder. Any such rate filing shall be accepted if the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area, and if the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area.

(g) *Filing of contracts and notification of abandonment.* Pipeline purchasers and large producer purchasers shall file, within 60 days of the execution thereof, each new contract and each contract amendment dated on or after March 18, 1971, for the sale of natural gas to them by a small producer pursuant to the exemption authorized hereunder and shall notify this Commission of the cessation of deliveries made by a small producer pursuant to the exemption authorized hereunder within 60 days of such cessation.

2. Part 154 is amended by revising paragraph (f) of § 154.91, § 154.104 and § 154.110 to read:

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"§ 154.91 Applicability.

* * * * *

(f) *Filings by certain non-signatories.* Where the operator and the signatory co-owners in a particular sale are exempt with respect to such sale pursuant to § 157.40, and where any non-signatory co-owner's interests are not covered by such exemption, such co-owner may file rate schedules, rate changes, or certificate applications with respect to such interests notwithstanding the provisions of paragraph (d) of this section.

* * * * *

§ 154.104 Annual statements by small producers.

Annual statements certifying to the matters enumerated in the form set out in §250.11 of this chapter shall be filed by all producers, either individually or by groups, who have been exempted under the provisions of Section 157.40. The statements shall be submitted by April 1 of each year for the preceding calendar year.

* * * * *

§ 154.110 Applicability of §§ 154.92 through 154.102.

Sections 154.92 through 154.102 shall apply only to those persons specified in § 154.91 and shall not apply to small

producer sales which are exempted under §157.40 of this chapter."

(B) Part 250 of Subchapter G, Chapter I, Title 18 of the Code of Federal Regulation is amended by revising § 250.10 as follows:

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The title of § 250.10 is revised to read:

§ 250.10 Application for small producer exemption

The text of § 250.10 is revised by substituting therefor the form entitled "Application for Small Producer Exemption" as set out in Attachment A hereto.

(C) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

(D) The amendments adopted herein shall be effective 45 days from the date of issuance of this order.

By the Commission.

( S E A L )

Kenneth F. Plumb,
Acting Secretary.

§ 260.10

# APPLICATION FOR SMALL PRODUCER EXEMPTION

(See § 157.40(b)(3))

NOTE: Independent Producers of natural gas whose total jurisdictional sales on a nationwide basis for the preceding calendar year, combined with those of "affiliated producers," were not in excess of 10,000,000 Mcf may file the information called for in this form for a Small Producer Exemption to sell gas (in four copies). Include volume of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within Section 157.40 has an interest in such sales. Do not include sales made pursuant to percentage sales contracts. If insufficient space is given for a complete answer, continue the answer on the reverse side or on a separate sheet, noting the relevant number.

| 1. NAME OF APPLICANT | 2. STATE OF ORGANIZATION |
|---|---|
| | |

| 3. LOCATION OF PRINCIPAL PLACE OF BUSINESS | 4. TYPE OF ORGANIZATION (Corporation, partnership, joint venture, etc) |
|---|---|
| | |

5. PERSON RESPONSIBLE FOR APPLICATION

| NAME AND TITLE | MAILING ADDRESS |
|---|---|
| | |

6. TOTAL JURISDICTIONAL SALES VOLUMES AT ______ PSIA FOR CALENDAR YEAR PRECEDING APPLICATION. (If more than one applicant is to be covered by this exemption, give the total jurisdictional sales volumes of each applicant separately.)

7. LIST ALL CERTIFICATES PRESENTLY HELD BY DOCKET NUMBER AND LIST ALL CONTRACTS ON FILE WITH THE COMMISSION AS RATE SCHEDULES BY RATE SCHEDULE NAME AND NUMBER. INCLUDE IN SUCH LISTING APPLICANTS' INTERESTS IN GAS SALES COVERED BY OTHER PRODUCERS' CERTIFICATES AND RATE SCHEDULES. LIST ALL INTEREST OWNERS AND THE AMOUNT OF THEIR INTEREST FOR EACH SALE TO BE COVERED BY THIS EXEMPTION. (See reverse side for reporting)

8. LIST ALL OWNERS OF MORE THAN 10 PERCENT INTEREST IN APPLICANT: (A) INDIVIDUAL NAME; (B) PERCENT OF OWNERSHIP

9. LIST ALL INTEREST OWNED BY THE INDIVIDUALLY NAMED OWNERS IN OTHER NATURAL GAS COMPANIES: (A) INDIVIDUAL NAME; (B) COMPANY NAMES; (C) PERCENT OF APPLICANT OWNERSHIP.

10. LIST FOR EACH OWNER THE POSITIONS HELD BY THESE INDIVIDUAL OWNERS IN APPLICANT COMPANY OR ANY OTHER NATURAL GAS COMPANY.

11. IS APPLICANT OR ANY INDIVIDUAL OWNER LISTED, AFFILIATED WITH ANY PURCHASER OF JURISDICTIONAL GAS FROM APPLICANT? (If so list name of buyer and seller for each sale and nature of affiliation.)

| SIGNATURE | TITLE | DATE |
|---|---|---|
| | | |

FPC Form 310-A
Rev [illegible]

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SALES UNDER RATE SCHEDULE OF APPLICANT

| APPLICANT | DOCKET NUMBER | RATE SCHEDULE NUMBER | INTEREST OWNERSHIP UNDER RATE SCHEDULE | |
|---|---|---|---|---|
| | | | NAME | PERCENT INTEREST |

APPLICANT'S SALES UNDER RATE SCHEDULE OF OTHERS

| OTHER SELLER | DOCKET NUMBER | RATE SCHEDULE NUMBER | APPLICANT'S PERCENT INTEREST IN RATE SCHEDULE |
|---|---|---|---|

NOTE: Place an asterisk (*) after each co-owners name whose interest is not to be covered by the Small Producer Exemption applied for.

FPC Form 330-4
Rev (6-72)

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APPLICATION FOR REHEARING

FEDERAL POWER COMMISSION ORDER NUMBER 428

DOCKET NUMBER R-393

EXEMPTION OF SMALL PRODUCERS FROM REGULATION

ORDER ISSUED, MARCH 18, 1971

COMES NOW, James M. Forgotson, Sr. of 409 Beck Building, Shreveport, Louisiana 71101, an independent producer of natural gas with production in Louisiana, Texas and Arkansas and applies through his designated attorney to the Federal Power Commission for a rehearing in the above designated matter, pursuant to Section 1.34 of the Rules of Practice and Procedure of the Federal Power Commission and Section 19(a) of the Natural Gas Act (15 U.S.C. Sec. 717(r)(a)).

Specifically the applicant contends that the Federal Power Commission lacks jurisdiction to issue order Number 428. This is because by the passage of time, the change in the conditions of the natural gas and energy situation and market in the United States and the world, technological changes, and actual experience with regulation of independent producers of natural gas for approximately seventeen years, the determination by the Supreme Court of the United States in *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954) that the Federal Power Commission has

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jurisdiction over independent natural gas producers, while constitutional then, is now unconstitutional. Specifically, the Supreme Court of the United States has held in *Abie State Bank*

v. *Weaver,* 282 U.S. 765 (1931) that statutes which were once constitutional can become unconstitutional by the passage of time and actual experience encountered in the administration and application of said statutes. The applicant contends for the same reasons set forth in his original written comments, as submitted to the Commission in the Rulemaking Procedure leading to issuance of Order 428, that regulations, particularly commodity price controls by the Federal Government, in the absence of any showing of war emergency or monopoly, *applied solely to one fuel or energy commodity, namely–processed natural gas*–constitutes such invidious discrimination against the independent producers thereof that it violates the guarantees of the Constitution of the United States against the deprivation of property without due process of law. *Morey* v. *Doud,* 354 U.S. 457 (1957).

Specifically, the applicant requests that the Commission give consideration to this question of jurisdiction over all independent producers in light of the guarantees of the Fifth Amendment to the Federal Constitution, clearly set out in the applicant's original comments on this matter.

Furthermore, the applicant directs the attention of the Commission to the Commission's own activities in considering licenses for cryogenic

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tanker importation of liquified natural gas from Algeria at a proposed initial rate of 365 billion cubic feet annually, to cope with the current domestic gas and energy shortages, at prices during non-peak shaving conditions several times the currently permitted well head prices for domestic natural gas. Those prices themselves assume that the concept is feasible, tanker capacity is available, and the claimed processing and shipping prices of the liquified gas hold firm. This action is occurring while the domestic industry and the nation are suffering from

several years of decreasing gas reserves and ratios of gas discoveries to consumption, directly attributable to a venture capital shortage created by the Commission's own unconstitutional price control practices. This is a clear indication of the total failure of the Commission and the Natural Gas Act as applied to *all* independent producers to protect the consumers against unreasonable or high prices or maintain a healthy domestic industry. Adding the aspirin of Order 428 to treat the pains of the brain tumor created by the Commission's regulation of independent producers will do nothing to solve the basic problem, but can serve as a cover-up that "something" is being done.

Respectfully submitted,

/s/ Edward H. Forgotson

Edward H. Forgotson
Stroud & Smith
1407 Main, Suite 1300
Dallas, Texas

Attorneys for Applicant

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## AFFIDAVIT

March 29, 1971

STATE OF TEXAS )
)
COUNTY OF DALLAS )

I, Edward Herman Forgotson, attorney for James M. Forgotson, Sr., having been duly sworn, testify and depose that the contents of this Application for a Rehearing in the F.P.C. Docket Number R-393 proceeding are true and correct.

/s/ Edward Herman Forgotson
Edward Herman Forgotson

SUBSCRIBED AND SWORN TO BEFORE ME this 29th day of March, 1971.

/s/ Kathryn E. DeCarlucci
Notary Public in and for
Dallas County, T E X A S

My Commission Expires:
June 1, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR 250.11]

Before Commissioners: John N. Nassikas, Chairman; Lawrence J. O'Connor, Jr., and Albert B. Brooke, Jr.

Exemption of Small Producers ) Docket No. R-393
From Regulation )

ORDER NO. 428-A

ORDER REVISING ANNUAL STATEMENT

(Issued April 9, 1971)

The Commission on July 23, 1970 issued a notice of proposed rulemaking in this proceeding (35 F.R. 12220, July 30, 1970) proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers as defined therein. Thereafter, the Commission in its Order No. 428 issued March 18, 1971[1] established a blanket certificate procedure for small producers applicable to all small producer sales made nationwide under existing and future contracts.

The Commission indicated in Order No. 428 that by subsequent order it would amend Section 250.11 to provide for a revised annual statement to be filed commencing in 1972 by small producers operating under blanket certificates issued pursuant to that general order. The annual statement to be submitted by small producers has been expanded to show, in addition to the total jurisdictional sales volume, a breakdown of such sales by area, volume, purchaser and price.

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*The Commission finds*:

[1] 36 F.R. 5598, March 25, 1971

(1) The notice and opportunity to participate in this rulemaking proceeding through the submission, in writing, of data, views, comments and suggestions are in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code.

(2) The action taken herein is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modifications adopted herein to the amendment proposed in the notice of this proceeding are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

*The Commission*, acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o, *orders*:

(A) Part 250 of Subchapter G, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising § 250.11 as follows:

The title of § 250.11 is revised to read:

§ 250.11 Annual statement for independent producers holding small producer exemptions

The text of § 250.11 is revised by substituting therefor the form entitled "Annual statement for independent producers holding small producer exemptions" as set out in Attachment A hereto.

(B) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

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(C) The amendment adopted herein shall be effective 30 days from the date of issuance of this order.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Acting Secretary.

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Attachment A - Page 1 of 1

§ 250.11 Annual Statement for Independent Producers holding Small Producers Exemptions.

(See § 157.40 of this chapter)

I hereby certify that total sales subject to the jurisdiction of the Federal Power Commission made by the undersigned and its affiliates for the calendar year 19__ were ____________________ Mcf at 14.65 psia. The pertinent information relating to each of these jurisdictional sales is as follows:

| Area | Purchaser | Volume | Price |
|---|---|---|---|

____________________
(Name of Small Producer)

____________________
(Signed)

____________________
(Representative Capacity)

____________________
(Docket No.)

FPC Form 314-B
(3-71)

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers )
From Regulation ) Docket No. R-393

APPLICATION FOR REHEARING AND RECONSIDERATION OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

Now comes the Independent Natural Gas Association of America (INGAA) and, pursuant to Section 19(a) of the Natural Gas Act (15 USC 717r(a)) (Act) and Section 1.34 of the Regulations under the Act, submits its Application For Rehearing and Reconsideration of Order No. 428 issued herein on March 18, 1971.

The person upon whom service of pleadings, documents or communcations with respect to this matter should be made is:

Jerome J. McGrath, Vice President and
General Counsel
Independent Natural Gas Association of America
1660 L Street, N. W.
Washington, D. C. 20036
293-5770

I

INGAA is a non-profit national trade association representing virtually all of the major long distance natural gas transmission lines in the United States, all of which are subject to the jurisdiction of the Commission under the Act. Most, if not all of these companies are directly affected by the Commission's

Order No. 428 herein. Its membership also includes producers and distributors of natural gas.

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II

In this rulemaking proceeding,[1] the Commission proposed to exempt from regulation under the Act all existing and all future jurisdictional sales made by small producers, i.e., those whose jurisdictional sales, including those of affiliates, do not exceed 10,000,000 Mcf in a calendar year. Under the proposal as noticed, such small producers would be exempted from "all provisions" of the Act and the Commission's Regulations otherwise applicable to the jurisdictional sales covered by such exemptions, except for the requirement that they submit annually a report setting forth their total volume of jurisdictional sales. Further, the Commission proposed to permit pipeline purchasers to file rate increases limited to tracking rate increases resulting from the exemption of small producers, waiving, where necessary, the requirement for supporting schedules under Section 154.63 of the Regulations, provided such schedules are submitted within four months from the date of the pipeline's increased rate filing. The Commission also stated that the rate or rates as revised by such tracking filings could be collected subject to reduction and refund from the effective date of such rate increase. No mention was made in the Notice that the Commission intended to regulate small producers through, and at the expense of, the pipeline companies. On the basis of the proposal as

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noticed, INGAA did not file comments, taking a neutral position on the question at issue. Order No. 428, INGAA submits,

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[1]Notice of Proposed Rulemaking dated July 23, 1970.

goes far beyond the scope of the rule as noticed herein to the detriment and serious injury of the interstate pipelines and, is therefore unlawful and in violation of the Administrative Procedure Act (5 USC 551, et seq.) and should be set aside, modified, or re-noticed as hereinafter set forth.

III

The Notice of Proposed Rulemaking in this docket, dated July 23, 1970, gave not the slightest hint that pipeline companies would be required to bear the full burden of small producer regulation. The notice simply indicated that small producers would be free of area price limitations in future sales contracts, and, while stating that pipelines would be permitted to file tracking increases, there was no indication that pipelines could file such increases only "if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or standards, affect the pipelines average cost of purchased gas by one mill or more."

Most egregious, however, the Notice gave absolutely no indication that small producer regulation would be carried on at the "pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales" (Order, p. 4). Consequently, since there was no reference to pipeline level regulation in the Notice, all the intrastate sales

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reference guidelines are novel, and appear in the Order for the first time. These reference standards are too vague and uncertain to be workable, and do not provide pipelines with assurance that their purchase costs will be allowed.

Because the Notice was silent on all of these points, neither INGAA, its pipeline members, nor any other interested

party had the opportunity to comment as they are entitled to do under Sec. 553 of the Administrative Procedure Act.

IV

INGAA is keenly aware of the Commission's objective, as stated in the Order (p. 3), to assure maintenance of an adequate gas supply for the interstate market. But to shift the burden of rate justification from small producers to pipelines would deter rather than encourage pipelines in seeking out small producers for new supplies.

Under Order No. 428 the burden of justifying exempted small producer rates falls squarely on the pipelines with no protection accorded them against refunds and without any assurance that the prices paid for gas purchased from such producers will be able to measure up to the vague standards which the Commission indicates it will use. The Commission states that the issue will be resolved either in a pipeline rate case or a proceeding involving only the tracking increase. In either event, the standard which the Commission ostensibly would use to determine whether

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the contract rate is "unreasonably high" is to compare the rate with the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Pipelines must not be required to meet this standard at the risk of disallowance of purchased gas costs. Hard evidence of intrastate gas sales prices are almost impossible to obtain, at least by private parties, and, rather, are the subject of rumor, speculation and uncertainty. A pipeline company in need of gas is thus put in the untenable position of having to negotiate with the small producer for gas at a price which may at some date in the future be declared to be unreasonable and thus subject to roll back and refund of uncertain

amounts, depending upon the rate level which the Commission considers to be the maximum which the pipeline should have paid.[2] Moreover, the Commission states that is reserves the right to require a pipeline to file all information required by § 154.63 if it deems such information to be necessary (Ord. p. 9), and further, that in making its determination [on the reasonableness of the small producer rate] it will consider "all relevant factors", citing the decisions of the Supreme Court in *Permian* and the Fifth Circuit Court of Appeals in *Southern*

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*Louisiana.*[3] As a general proposition such pronouncements may well be appropriate but in the context of this proceeding they raise the grim spectre of producer price regulation imposed at the pipeline level with months, perhaps years of rate uncertainty and the prospect of retroactive ratemaking. Such indirect regulation of producer prices is far beyond the purview of the Act and we submit is an unlawful burden to be placed upon the pipeline companies.

It is INGAA's position that to require refunds from a pipeline because a producer received prices which the Commission subsequently determines to be too high is impermissible under the Act. Even if one were to assume that refunds due solely to small producer rates were lawful, the possibility of pipeline rate reductions due to other unrelated cost factors, which is clearly

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[2]Contrast this uncertain treatment of pipeline gas cost with the Commission's statement, "We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change" (Order No. 428, page 3). No attempt has been made to justify the irrational disparity of treatment between the two parties to the same contract, both of which are subject to the Commission's jurisdiction.

[3]*Area Rate Proceeding (Permain Basin Area)*, 390 U.S. 747 (1968); *Austral Oil Co.* v. *F.P.C.*,______F.2d______ (Fifth Circuit 1970, Slip opinion dated March 19, 1970, No. 27492, *et al.*)

present in the approach the Commission has now fashioned for pipelines in regulating small producers, is manifestly unlawful. The Act does not give the Commission the authority to make reparations or to make retroactive adjustments in rates. Further, tracking rate increases related solely to purchased gas costs cannot and should not be used as a means for reducing a pipeline company's filed effective rate except prospectively within the framework of Section 5 of the Act. *FPC* v. *Hope*

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*Natural Gas Company*, 320 U.S. 591 (1944); *Montana-Dakota Utilities Co.* v. *Northwest Public Service Co.*, 341 U.S. 246 (1951); *FPC* v. *SunRay DX Oil Company*, 391 U.S. 9, 23-24 (1968).

V

In its Order, the Commission seems to imply that since small producer sales amount to only about ten percent of the total gas purchased by interstate gas pipeline companies, the impact of this regulation will not seriously affect the pipelines. This is not true. For many companies substantial variation in purchased gas costs attributable to small producers could significantly affect earnings and produce rate and financial uncertainty.

In 1968, independent producers domestically sold interstate pipelines a total of 12,214,721 MMcf of natural gas at a cost to the pipelines of $2,101,202,000.[4] Assuming small producers account for ten percent of this amount, it can be seen that this is a sizeable figure. It is not inconceivable that producer prices in the next few years could increase by as much as a third or more, such that the pipelines would be encountering

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[4]Sales by Producers of Natural Gas To Interstate Pipeline Companies, 1968.

purchased gas cost increases from small producers alone of as much as $75,000,000. Despite the urgency of the gas supply situation with which the Commission, the pipelines and all interested persons are properly



concerned, this is a large sum of money to be paid by pipelines without any real certainty that they can recover the increased costs. It is INGAA's firm belief that the key to finding and committing new reserves to the interstate market is through increased area prices, and that creating price disparity between small and large producers and shifting the rate justification burden from the small producer to the pipeline purchaser can only hinder the efforts to end the supply crisis. Thus INGAA submits that the price paid small producers should bear some relationship to the applicable area rate or guideline ceiling price, particularly where, as here, the *purchasers* are faced with the burden not only of justifying the *seller's* price but also of having to refund those amounts found by the Commission at some later date to be unreasonable. Also, at the very least, the Commission should establish procedures whereby it can obtain and make available to prospective interstate purchasers all pertinent intrastate sales contract price data. See, e.g., Docket No. R-389A, Notice of Investigation, dated July 17, 1970, and letter of Staff dated September 9, 1970, in response thereto, transmitting data gathered on intrastate sales.[5] In this regard it is also urged that the Commission issue an official list of producers who have small producer certificates in order for the pipelines to pay and track accurately

[5]While INGAA does not suggest any particular procedure to be followed, other parties filing may do so. In any case, this matter should be re-noticed so that all interested parties may comment on such procedures and other pertinent matters. (see infra p. 10).

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the resultant increases and that such list be issued no later than 45 days prior to the effectiveness of any small producer exemption.

VI

The pipelines are faced here with the sort of troublesome and unreasonable burdens imposed by the Commission's Purchased Gas Adjustment Provisions in Docket No. R-406, which is now pending before the Commission. Commenting on the provisions proposed there which are similar in many respects to those set forth in Order No. 428, INGAA stated:

> ". . . [T]he pipeline companies under the procedures prescribed here would be faced with the exposure of rate refunds unlimited as to amount and periods for which such refunds could be required. This in turn would lead to uncertainties as to earnings, which would make more difficult an already difficult financing situation where securities are to be issued. A pipeline company would have no definite record or estimate of earnings, it would be unable to determine with any degree of accuracy whether or by how much it was complying with the coverage requirements of earlier debt issues, and it would be precluded from relying upon current earnings in issuing long term debt securities. The ever-present spectre of reparations and retroactive ratemaking would undermine investor confidence and would create an intolerable financial situation for the companies."

The Commission justifies its action in this regard by stating that the regulation of small producer rates through regulation of pipeline rates will be "protective of consumer interest". While protection of the consumer is the primary aim of the Act,

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INGAA believes the consumer has

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just as much at stake as the industry in securing a plentiful supply of gas. It is not unreasonable, therefore, to place some of the risk of small producer non-regulation on the consumer and not all of it on the share-holders of the pipelines as Order No. 428 would do. There should be a sharing of the risk just as there should be a sharing of the benefits.

VII

Order No. 428 would permit tracking increase filings only where small producer rate increases, or such increases together with other increases authorized for tracking, affect the pipeline's cost of purchased gas by one mill or more. This is the same triggering level to which INGAA objected in Docket No. R-406 and the same objection applies here. This amount is excessive for many pipelines and could lead to an unreasonable lag between increased producer costs and the filing of tracking increases. INGAA would urge that a minimum dollar amount be fixed on a company by company basis for activating a tracking increase, tailored to meet the individual company's needs. Alternatively, INGAA would urge that the adjustment amount be reduced to one-tenth mill ($0.0001) per Mcf where the particular pipeline designs its rates to that tolerance.

VIII

As noted previously herein, the Notice of Proposed Rulemaking failed to give any indication that the Commission intended to make the pipelines bear the brunt of small producer regulation. These are matters

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of substance within the meaning of § 553 of the Administrative Procedure Act and should have been set forth in the Notice so that all interested parties would be afforded the opportunity to comment. The Notice was therefore defective and the instant order invalid. *Texaco Inc.* v. *FPC*, 412 F. 2d 740 (CA3, 1969). There the court said (p. 744):

> "Section 553 was enacted to give the public an opportunity to participate in the rule-making process. It also enables the agency promulgating the rule to educate itself before establishing rules and procedures which have a substantial impact on those regulated. See *Pacific Coast European Conference* v. *United States*, 350 F. 2d 197, 205 (9th Cir.), cert. den. 382 U.S. 958 (1965). These procedures must be followed when an agency is exercising its legislative function in order that its rules have the force of law." Citing *NLRB* v. *Wyman*, 394 U.S. 759, 89 S. Ct. 1426 (1969).

Unless the Order herein is rescinded or modified so as to remove the onerous and unlawful burdens on the pipelines, INGAA submits that the pipelines will have been denied the due process of law to which they are entitled under the Constitution, the Act and the Administrative Procedure Act.

## CONCLUSION

Wherefore, in consideration of all of the above, INGAA urges the Commission to grant rehearing and that (1) it reconsider and modify its Order No. 428 so as to eliminate the burdensome and unlawful requirements imposed on pipelines purchasing natural gas from small producers or (2) renotice its proposal and set forth with particularity the manner in

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which it would (a) propose to exempt small producers from the provisions of the Act, (b) the extent to which the pipelines would be required to shoulder the regulatory responsibilities of the exempted small producers, and (c) the procedures it would establish to permit tracking increases by pipelines.

Respectfully submitted,

INDEPENDENT NATURAL GAS
ASSOCIATION OF AMERICA

By /s/ Jerome J. McGrath
Jerome J. McGrath
Vice President and General Counsel

Washington, D. C.

April 16, 1971

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CITY OF WASHINGTON )
) SS
DISTRICT OF COLUMBIA )

Jerome J. McGrath, being first duly sworn according to law, says that he is Vice President and General Counsel of Independent Natural Gas Association of America; that he has read the foregoing Application for Rehearing and Reconsideration and is familiar with the contents thereof; and that he has executed same on behalf of said Association with full power and authority to do so.

/s/Jerome J. McGrath
Jerome J. McGrath

Subscribed and sworn to before me, a Notary Public in and for the District of Columbia, this 16th day of April, 1971.

/s/ Etha L. Connor
Notary Public

My Commission Expires:

August 14, 1974

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BEFORE THE

FEDERAL POWER COMMISSION

| | | |
|---|---|---|
| In the matter of | ) | |
| | ) | Docket No. R-393 |
| Exemption of Small Producers | ) | |
| From Regulation | ) | |

APPLICATION FOR REHEARING
OF
TENNESSEE GAS PIPELINE COMPANY,
A DIVISION OF TENNECO INC.

Pursuant to Section 19(a) of the Natural Gas Act and Section 1.34 of the Commission's Rules of Practice and Procedure, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee), having previously filed comments in the above-captioned proceeding and being aggrieved by the Commission's Order No. 428 issued herein on March 18, 1971, hereby applies for rehearing with respect to that order.

In said Order No. 428, the Commission undertakes (1) to exempt all existing and future jurisdictional sales made by "small"producers, *i.e.*, producers whose jurisdictional sales do not exceed 10,000,000 Mcf annually, from regulation under the Natural Gas Act and the Commission's regulations thereunder[1] and (2) to substitute, as the means of providing the requisite consumer protection, a vague "market mechanism" standard

[1]Under Order No. 428, such producers would be required only to submit annually a report as to their total volumes of jurisdictional sales during the past year and possibly comply with Section 7(b) of the Act in some situations.

under which the impact of Commission's omission of small producer regulation would be shifted to the pipelines (Order p. 8).

For the reasons set forth below, Tennessee submits that the Commission should grant rehearing and, upon such rehearing, to set aside Order

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No. 428 as arbitrary, capricious, violative of both the Natural Gas Act and the Administrative Procedure Act as well as fatally vague and ambiguous.

I

Order No. 428 sets forth a number of reasons, purportedly in justification for exempting "small" producers from regulation under the Natural Gas Act. However, as shown below, these reasons are unsound, invalid and internally inconsistent.

(a) As its first reason, the Commission asserts (Order p. 3) that the proposed exemption "shall encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas," thereby constituting "an important step forward" in the meeting of the "Commission responsibilit[y] under the Natural Gas Act * * * to assure maintenance of an adequate gas supply for the interstate market."

But, in undertaking to provide to the producers qualifying as small producers incentives over and above those to be provided to the producers not so qualifying, the Commission implicitly assumes that small producers need incentives over and above those to be provided other producers in order to induce them to increase their exploratory efforts. Not only is there

nothing to support that assumption, but there is nothing to support the inclusion in the small producers exemption of all who produce up to 10,000,000 Mcf a year.[2] As a result, the small producer exemption

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actually may operate to undercut the Commission's efforts also to provide incentives to other producers to increase their exploratory efforts. And, since these other producers constitute the larger part of the producing industry, the net effect of the proposed small producer exemption may be to operate as a depressant, rather than a stimulus, upon the needed exploratory activities.

This is particularly so since, contrary to the Commission's apparent assumption, the fact that there is a fixed limit on the annual production permitted in order to qualify for the exemption, might, as a practical matter, result in limiting the volumes of additional gas which such producers would be willing to make available for the interstate markets. Since the exemption, in effect, thus provides an incentive for a producer to remain small, small producers discovering new gas obviously would prefer selling it in the intrastate, rather than the interstate, markets, in order to avoid jeopardizing the exemption, particularly if the producer's production is already nearing the 10,000,000 Mcf level on an annual basis.

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[2] To be sure, the Commission had defined small producers in terms of 10,000,000 Mcf annual production for the purpose of relieving them from certain of the filing requirements under the Act and Commission regulations. See *Permian Basin Area Rate Case*, 34 F.P.C. 159, 234-236. However, inasmuch as the small producer classification in *Permian* was not used in connection with an exemption from Commission rate regulation, as in the instant proceeding, the justification for the classification in *Permian* does not necessarily carry over here.

The proposed exemption would have a depressant effect upon the availability of new gas for the interstate markets in still another way. Order No. 428 provides (p. 6), that

> "the royalty interests stand in the same shoes as the working interest owners. Consequently, if a relates to a small producer sale, such interest shall be exempt, but if it applies to any other sale, it will not be exempt."

Since the effect of this provision is that the royalty payments by small producers would be based on the "market value" nonregulated price whereas

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royalty payments by large producers would be based on the lower regulated price, a landowner would obviously prefer to lease his potential gas-producing properties to small producers, with the results just discussed.

(b) To be sure, the proposed exemption might result in a marked increase in the gas available to the interstate markets if it brought about a proliferation in the number of small producers and such new small producers engaged in successful exploratory activities. But, if it did, it would increase the volume of gas produced by small producers generally and to this extent, undercut the Commission's second reason for exempting them from rate regulation under the Act, *i.e.*, that such exemption would not have a significant impact upon the purchasing pipelines.[3] In this regard, it should be noted that the

[3]The Commission apparently referred to the pipelines rather than the consuming public since under the substitute regulatory scheme proposed by it, the pipelines are to absorb the costs of any excessive price paid to the small producers through disallowance of such cost in the pipelines' cost of service. See *infra* pp. 9-10.

statistics set out in the Commission's Order patently grossly understate such impact, even assuming that the numbers thus set out are otherwise accurate.[4]

In addition to the fact that the use of averages minimizes the magnitude of small producer sales for a number of pipelines (see *Permian Basin Area Rate Case*, Supra at 235), the statistics used by the Commission admittedly "do not include resales to pieplines by large producers of gas purchased from small producers." (Order p. 3, fn 1) Yet, Order No. 428

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(at p. 5) explicitly provides for such resales to be included within the proposed exemption, and the transcript of the conference held indicates that the volumes involved may well be very substantial. For example, while he could not quantify the volume purchased from small producers, Counsel for Phillips Petroleum Company indicated that between 40 and 50% of its total jurisdictional sales represent purchases from other producers (including small producers) (Tr. 21). Counsel for Signal Oil and Gas Company indicated that Signal has

> "very, very little production of [its] own. Almost 100% is purchased from other producers * * * * * * [I] t looks to us like between 60 and 70 percent of the gas that we sell presently comes from small producers." (Tr. 45-46)

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[4] Although the statistics set out in Order No. 428 purport to be based on figures taken from the 1969 Forms 2 and 2-A, the underlying computations by which the statistics are arrived at are not a part of the record and have not otherwise been made available.

sold which would come within the exemption would be substantially greater than indicated by the statistics set forth by the Commission.[5]

In any case, even as adjusted to include such large producer resales, the Commission's statistics would still fall short of reflecting the true impact of the exemption. This is so because (1) the statistics used relate to a period when the proposed exemption was unavailable, and (2) the very purpose of the proposed exemption is to encourage increased exploration, and thereby, to increase the production and sale of gas by small producers in the interstate markets. To the extent that this purpose is achieved and brings about the sought-after increase in small producer sales, the result would be an increased impact upon the pipelines. Plainly, therefore, the statistics

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relied on by the Commission do not provide any measure of the impact of the proposed exemption upon the pipelines and further proceedings are obviously in order before any meaningful determination of that impact could be made.

(c) The Commission's final reason, *i.e.*, that the exemption would "relieve the small producer of the expenses and burdens relating to regulatory matters" (Order p. 3) loses much of its force when it is remembered that the Commission has already relieved the small producers in the Permian Basin and Southern Louisiana areas from the need to file certificate and rate applications as long as the rates charged do not exceed the applicable area rates. See 34 FPC 434, Sec. 157.40 of the Commission's Rules and Regulations. Extension of these provisions

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[5] The nature of the underlying rulemaking proceeding and the lack of an evidentiary record makes it impossible to ascertain the full thrust of the proposed exemption.

to other areas would appear to be sufficient without more to relieve the small producers of the expenses and burdens relating to regulation.

II

Since the effect of exempting the small producers from the rate regulatory provisions of the Natural Gas Act provided in Order No. 428 is to enable such producers to collect prices in excess of the applicable area rates or guideline rates, Order No. 428 has sought to provide substitute safeguards in order to insulate the consuming public from the unreasonably high small producer prices which might result. These substitute safeguards are in the form of imposing the responsibility upon the pipelines of guarding against contracting to pay excessive prices to the small producers on penalty of suffering disallowance of the excessive portion from their cost of service.

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Such substitute regulatory scheme not only departs improperly from that provided by Congress in the Natural Gas Act, but, without warrant, imposes the burdens of small producer regulation and the resulting uncertainties and exposures to potential disallowances of costs upon the pipelines. And, since there is nothing in the Commission's Notice of Proposed Rulemaking dated July 23 1970, indicating any intention to impose these burdens upon the pipelines, Order No. 428's imposition of such burdens upon the pipelines violates Section 3 of the Administrative Procedure Act (5 U.S.C. 551, 553).

(a) It has been established since the Supreme Court decided the first *Phillips* case (*Phillips Petroleum Company* v. *State of Wisconsin*, 347 U.S. 672) in 1954, that the Natural Gas Act vest in the *Commission* the responsibility for regulating the rates for *all* wholesale sales of natural gas in interstate

commerce, regardless of the classification (pipeline or producer) or size (large or small) of the seller. See also *Deep South Oil Company of Texas* v. *F.P.C.*, 247 fF.2d 882, 884, 887 (5th Cir. 1957) (holding the sales of natural gas by "a small unintegrated corporation engaged in the exploration for and the production of oil and gas" to be subject to regulation under the Act); *Saturn Oil & Gas Co.* v. *F.P.C.* 250 F. 2d 61, 66-67 (10th Cir. 1958).

The Commission purports to find the requisite power to waive its admitted jurisdiction in *F.P.C.* v. *Hunt*, 376 U.S. 515 (1964) and *Permian Basin Area Rate Case*, 390 U.S. 747 (1968). But neither of these cases support the Commission's position. The *Hunt* case involved the question of the Commission's power to condition a temporary certificate upon the

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maintenance of a prescribed price during the period of temporary authorization; the comment of Mr. Justice Clark (376 U.S. at 527) relied on by the Commission here thus is pure dictum and the reference to the National Labor Relations Board suffers from the infirmity that it relates to an entirely different type of situation.[8]

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[8]In *Hunt* and his dissent in the second *Phillips* case (*State of Wisconsin* v. *F.P.C.*, 373 U.S. 294, 328-330 (1963)), Mr. Justice Clark suggested that the Commission look to the National Labor Relations Board for a method of handling exemptions. However, in addition to the fact that the National Labor Relations Act vests discretion in the Board whether to exercise its jurisdiction (see 29 U.S.C. 160(a)), the effect of such a Board waiver is to cede jurisdiction to a state and territorial agency. Here, in contrast, there is neither express authority in the Commission to waive jurisdiction nor does a local agency exist with power to regulate small producer sales of natural gas for resale in interstate commerce in the event of such a waiver. Indeed, the existence of such a local body would be at odds with the purpose of the Commission's action here, which is to free small producer sales from *all* direct regulation.

Moreover, while the Supreme Court in *Permian* approved the special small producers provisions there prescribed by the Commission, these special provisions plainly did not extend to exempting these producers from area prices. To the contrary, the Commission there expressed strong doubts whether it had the authority to provide such an exemption, stating (34 F.P.C. at 234):

> "While we are convinced that there is a need for distinctive treatment for small producers . . . we do not believe it is necessary or desirable to provide outright exemption. We reach this conclusion assuming that exemption is legally permissible despite the mandatory language of Sections 4 and 7 of the Natural Gas Act.[49]

[49]Section 4(a) states in part that "*all* rates and charges" by "any natural gas company shall be just and resonable." In Section 4(c) it is stated that "under such rules and regulations as the Commission may prescribe, *every* natural gas company shall file . . . . in such form as the Commission may designate, . . . *all* rates and changes . . ."

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Section 7(c) provides in part that "No natural gas company . . . shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity . . ." (emphasis in original)

Plainly, in these circumstances, the Supreme Court's affirmance in *Permian* of power in the Commission to exempt small producers from various filing requirements does not extend to the exemption of such producers entirely from the rate regulation provision of the Natural Gas Act, a provision which has been characterized as "the heart of the * * * regulatory system," *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 491, 611 (1944).

(b) Even if it be assumed *arguendo* that the Act vests discretion in the Commission whether to exercise jurisdiction over the small producers, there is nothing in the Act—and Order No. 428 contains no citation of authority—indicating any power in the Commission to shift the Commission's responsibilities to the pipelines and to require them to bear the costs, risks and uncertainties of assuring that the Commission's exemption does not redound to the detriment of the consumers. In other words, there is nothing in the Natural Gas Act authorizing the Commission (1) to shift its regulatory responsibilities with regard to small producers to the pipelines, subject to *post facto*, Commission "second guessing" and (2) to make the pipelines, rather than the small producers, bear losses which would result from a Commission determination upon such *post facto* review that a portion of the contract price should be disallowed as excessive.

While the Commission has authority in appropriate situations to inquire into the reasonableness of a pipeline's operating expenses and to disallow those items of costs found to be imprudent, such authority does

not extend to the cost of purchased gas. Rather, it extends at most only to those items of operating expense as to which the Commission has not been given direct regulatory authority. In contrast, the cost of purchased gas is the major item of expense in operating a pipeline system as compared to the other costs which are merely incidental thereto. Moreover, and more important in this regard, the Natural Gas Act specifically designates the Commission as the body responsible for regulating the prices at which such gas is sold for resale in interstate commerce. In addition, by focussing the jurisdictional impact upon the activities of the seller, Congress clearly intended that the burden of any excessive rates be borne by the seller, not the purchaser. In these circumstances, the Commission clearly has no power to discard this Congressionally prescribed scheme for regulating producer rates in favor of a "market mechanism" which shifts the burdens of consumer protection from those specifically designated by Congress to the pipelines.

(c) Particularly unjustified and unlawful is the Commission's attempt so to shift these Congressionally prescribed responsibilities to the pipelines with respect to the small producer contracts already in existence when Order No. 428 was issued. Since these contracts were entered into prior to the issuance of Order No. 428, and, in most instances, prior to the issuance of the Notice of Rulemaking culminating in the issuance of that Order, the pipelines could not have been on notice at the time they entered into these contracts that the existing regulatory scheme was about to be changed. In these circumstances, now to shift the responsibilities and to require the pipelines to bear the costs resulting from the disallowance

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as excessive of a portion of the contract price agreed upon prior to the issuance of Order No. 428, is tantamount to unlawful confiscation of property.

(d) Further compounding the Commission's error in this regard is vagueness and lack of certainty as the the standards to be applied by the Commission in determining whether the prices which a pipeline contracted to pay a small producer is excessive. Such certainty is required in order that a pipeline may make an informed evaluation of the exposures attaching to a proposed small producer gas sales contract before deciding whether to go ahead with the proposed contract.

To be sure, Order No. 428 (at p. 8) provides that pipeline rates will be subject to reduction and refund "with respect to new small producer sales * * * as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market prices for intrastate sales in the same producing area." But the "standards" thus provided are wholly vague and lacking in certainty.

To begin with, Order No. 428 is vague as to the applicability of the standards there provided by the Commission. While there appears to be no question but that the "standards" are to apply to "*new* small producer sales," it is unclear whether they also are intended to apply to prices paid by the pipelines under their *existing* small producer contracts. As indicated above, the only reference to these standards is in the context of *new* producer sales. Should the Commission intend that these "standards" not apply to exising small producer sales, then there is a complete absence from Order No. 428 of any reference to the standards to be applied with

reference to such existing sales. Indeed, it is even unclear whether the phrase, "new small producer sales," is intended to include a contract made to replace an expired one. Is such a contract to be considered a "new contract" for these purposes?

Further ambiguity arises from the provision that the determination of whether a rate is "unreasonably high" is to be made by "considering appropriate comparisons with," etc. What does "considering appropriate comparisons" mean? Does it mean that the "standards" thereafter listed are merely to be taken into account without having controlling effect? And, if so, does it mean that factors in addition to those listed are merely to be taken into account without having controlling effect? And, if so, does it mean that factors in addition to those listed are to be considered in making the "appropriate comparisons?" If the latter, then what are the additional factors, and what weight is to be given to these additional factors as against those specifically listed?

Assuming that only the factors specifically listed are to be considered in making the "appropriate comparisons," then it is unclear, since there are two "standards" listed, whether both are to be taken into account in making the determination, or only one. The ambiguity in this regard is accentuated by the use of the disjunctive "or." Suppose, for example, that "the highest contract price for sales by large producers" is found to be different–higher or lower–from "the prevailing market prices for intrastate sales in the same producing area." Is one to be controlling and if so, which one? If neither is controlling and both are to be taken into account, what is the weight to be given each?

Turning now to the "standards" themselves, what is meant by "the highest contract prices for sales by large producers?" Does the phrase "sales by large producers" include intrastate

sales as well as interstate sales? Nonjurisdictional direct sales as well as jurisdictional sales for

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resale? Does the phrase "the highest contract prices" include the highest contract price even if not paid or is it limited to the highest contract price actually paid? Does the phrase include more than one highest contract price, and if so, how are they to be used in making the "appropriate comparisons?" Suppose that the highest prices in a producing area turn out to be 29¢ and 30¢ per Mcf. Which price, if either, would be controlling? And how would the "appropriate comparisons" be made in these circumstances?

The second "standard," *i.e.*, "the prevailing market price for intrastate sales in the same producing area," similarly suffers from vagueness. What is meant by "prevailing market price?" Does it mean the current price at which new contract are being executed or the prices being paid under existing contracts? As to "market price," which price does it refer to if there are a number of sales at different prices? The highest, the lowest, the median, the average, weighted or unweighted?[9] Finally, what does "same producing area" include, the field from which the gas is produced or an area such as that used by the Commission in determining area prices are something in between?

Thus, these "standards" are so vague and ambigous as to not even provide a minimum of guidance as to whether a pipeline should or should not contract with a small producer.

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[9]Assuming, of course, that such information would be available to a pipeline which is negotiating a gas purchase contract with a small producer.

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III

By its order, the Commission purports to waive Section 154.63 of its Regulations to permit pipelines to "file rate increase applications to track small producer rate increases resulting from the exemption," provided that such small producer increases (combined with other increases authorized for tracking by unspecified Commission orders) "affect the pipeline's average cost of purchased gas by one mill or more."

(a) The Commission's Notice of Rulemaking did not propose a one mill triggering level as a condition to pipeline tracking of small producer increases. On the contrary, the Notice indicated that there would be *no* such triggering level. The Commission's order is, therefore, a wholly unlawful disregard of the notice requirements for rulemaking under Section 553 of the Administrative Procedure Act.[10] Not having given interested parties an opportunity to comment prior to the imposition of the one mill standard, the Commission cannot now lawfully or fairly impose that limitation upon Tennessee, now faced with a *surge* of increases attributable directly to the Commission's order.

(b) The one mill standard is demonstrably and unreasonably excessive, and unlawfully discriminates against the larger pipelines. For example, before Tennessee could "track" the effect of the Commission's

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[10] It should also be noted that no triggering level is imposed upon large producers as condition to their filing for increased rates to reflect the effect of the exemption. The Commission's order thus unlawfully and unduly discriminates against pipelines, and, in effect, casts the entire burden of the small producer exemption upon the pipelines to the extent that increases, as a result of the exemption, do not "affect" a one-mill increase in a pipeline's average cost of gas.

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order, it will have to absorb all small producer increases until it experiences an overall annual increase of approximately $1,200,000 in its purchased gas costs. Clearly, it is unreasonable to establish a standard which so forecloses a pipeline from securing timely and meaningful rate relief.

(c) The unreasonableness of the one-mill standard is further compounded by the fact, that under the procedures established by the Commission's order, small producer increases will not all become effective within a definite or known period of time. Rather, such increases will have to be paid by the pipelines in dribs and dabs as individual small producers sporadically file for and receive their exemptions. Thus, the larger pipelines, such as Tennessee, may have to absorb the various increases that do occur for a considerable period of time before all of the increases ultimately "affect" a one-mill increase in their average purchased gas costs.

(d) Order No. 428 also "reserves the right" to require any pipeline which files to track the small producer increases "to file *all* information" required by Section 154.63 of the Regulations. The earlier "waiver" of the requirements of those Regulations is thus qualified to impose upon the pipeline, at the Commission's election, and, apparently, at any time after a tracking filing is made, the burden of a full Section 4 showing, although the pipeline has only sought to reflect a change in cost of its gas purchases attributable to the small producer increases. Thus, each time a pipeline may seek to track small producer

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increases, it will be faced with a threat of, perhaps, years of rate uncertainty and instability because of the possibility that the Commission will utilize the opportunity to shift the evidentiary burden of proof under Section 5 of the Natural Gas Act to the

pipeline. The threat that such a procedure may be invoked is wholly unreasonable and unfair.

IV

Order No. 428 is unclear with respect to the need for a small producer to file an application under Section 7(b) in order to abandon service. On the one hand, the text of the order states (on p. 7):

> "We think it important to retain control over all abandonments of jurisdictional sales. For this reason, small producers should be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein.[4] We shall also require purchasers to notify us of the cessation of deliveries by a small producer regulated by the terms of this order within 60 days of such cessation."

Yet, on the other hand, the footnote to this statement contains the following comment (fn 4, p. 7):

> "If a contract for an exempted sale expires and is not excluded or replaced by a new contract, the small producer must continue the sale of such gas unless the pipeline consents to abandonment or the producer obtains abandonment authorization."

The inconsistencies between the text and the footnote, coupled with what is left unsaid, leaves unsettled the answers to many problems with respect to abandonment which are likely to arise under the proposed exemption.

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To begin with, the order leaves up in the air as to the

requirements for abandonment prior to the expiration of the contract; do the requirements of Section 7(b) continue to apply with full force prior to the expiration of the contract? And what is the situation with regard to Section 7(b) after the expiration of the contract? Suppose, in such circumstances, the pipeline consents to abandonment, is the small producer still required to seek abandonment authorization? If not, then is the pipeline's notification to the Commission "of the cessation of deliveries by a small producer" intended as a substitute for an abandonment application by the producer? Again, suppose that a pipeline refuses to "consent to an abandonment." Is the small producer then required to file an abandonment application?

Inasmuch as the portion of Order No. 428 dealing with abandonment talks in terms of a pipeline being the purchaser, the question comes up as to what is required as to abandonment when the purchaser is a large producer. Did the Commission intend that the requirements set forth when the purchaser is a pipeline should also apply when the purchaser is a large producer and, if not, then what requirements did the Commission intend to be applicable as to abandonment when the purchaser is a large producer?

Finally, since Order No. 428 would relieve the small producers of the obligation to file separate certificate applications with respect to each new sale, the question arises as to the requirements with regard to abandonment when the new gas sales contract is for a term of, say, two years, five years, ten years? Had the small producer been called upon to file a separate certificate application for each sale, in some

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instances of short term contracts he might have received a certificate of limited duration. Despite this, is it to be assumed in each instance that the obligation with respect to each new gas sale is for an indefinite period regardless of the term provided in

the contract? Or was it the Commission's intention in such circumstances that the small producer's obligation to deliver be only co-extensive under the term of the contract so that upon the expiration of the contract, it is to be presumed that the purchaser had given his "consent to abandonment" when he entered into the agreement and no further consent is required?

V

Order No. 428 wholly ignores the effect of small producer exemptions on currently effective procedures under which pipelines are charged and pay for the volumes which are delivered from various fields or gas producing units. Specific questions on this point were raised in Tennessee's comments, and again during the informal conference (Tr. 8, 13-14) because of the potential liability in the event payments are made based on erroneous billing submitted by a small producer, or by a large producer on behalf of the small working-interest owners.

(a) In *many* instances jurisdictional sales of natural gas may be made by producers, although the purchasing pipeline has *no contractual relationship* with the owner of the natural gas. Such situations arise primarily when a plant or property operator delivers

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natural gas under a contract with a pipeline, but for one reason or another, that contract has *not been executed* by other working-interest co-owners of the gas. This is generally known as a "non-signatory co-owner" sale under the existing Regulations [See Section 159.91(d) and (e)].

Under Order No. 428, volumes sold to the pipelines which are owned by a "small" non-signatory co-owner are exempted from further rate regulation. The question thus posed is, on what basis shall the pipeline be required to pay for volumes

attributable to non-signatory working-interest owners who qualify as small producers.[12] Under present regulations, such non-signatory co-owner volumes are covered by the operators' rate schedule and its filed rate because non-signatories may not file certificate applications, rate schedules or rate changes. The operator, in turn, bills for *all* volumes at its filed rate level. Clearly, if a pipeline pays on the basis of the large producer's billing at the filed rate level, it should not be subjected to claims at some later date that the small non-signatory co-owners were entitled to some higher rate, thus exposing the pipeline to the risk of retroactive increases.

(b) The other side of the problem is a situation where the operator of a producing property is a small producer, and the

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non-signatory co-owners (with aggregate working interest in excess of 12½ percent) do not qualify as small producers. In other words, a large producer's volumes are sold under the small producer's rate schedule, since there is no contract between the large producer and the purchasing pipeline. Under Order No. 428 (p. 16), a large producer in such a situation "*may*" (but is not required to) "file rate schedules, rate changes or certificate applications with respect to such interests * * *." The Commission should clearly specify (1) the pipeline's obligation if the "large" producer in that situation does not make the necessary filings; (2) the nature of the filings to be made by the large co-owner producer since there is no contract between him and the purchasing pipeline; and (3) the pipeline's obligations pending the Commission's acceptance of the filings which "may" be

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[12]Order No. 428 (p. 15, paragraph 5) provides that a large producer may file for the price specified in its contract for the *resale* of gas *sold* to it by a small producer. Under the "non-signatory co-owner" situation, there is no "*sale*" to the large producer by the small non-signatory co-owner, and, hence, there is no *resale* to which the large producer's filing can relate.

tendered by the large producer.

(c) Order No. 428 provides that small producers who have applied for small producer certificates are to be entitled to the exemption and such higher rates as may be applicable "as of 45 days from the date" of Order No. 428. This is plainly an illegal procedure since it would operate to provide a basis for small producers to claim retroactive increases in rates for sales to the pipeline purchasers, depending on when the Commission acts on the pending applications. The illegality is further aggravated by the fact that many "small" producers have not seen fit to serve Tennessee with their

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certificate applications for small producer status.[13]

Order No. 428 further provides that those producers which file applications for small producer certificates within 45 days of Order No. 428 will be entitled, upon issuanace of a certificate "regardless of the date of issuance of such certificate," to its small producer status "effective as of 45 days" from the date of the order. This, again, is a plainly illegal procedure designed to provide a basis for small producers to claim retroactive rate increases. For example, the Commission may not act on a pending small producer application for six months.

[13]The Commission's orders issuing small producer certificates have also consistently failed to indicate the purchasers. Thus, Tennessee in many instances has not had notice of either that small producer applications are pending, or that a producer had qualified for that status and received its small producer certificate. Tennessee may not have been served because it did not purchase gas from the particular producer in the area covered by the application. For example, under Order No. 428, a small producer's certificate covering Permian Basin sales, where Tennessee does not purchase, would now be applicable to sales to Tennessee by that same producer in other areas where Tennessee is a purchaser.

Under Order No. 428, the pipeline purchaser would be subject to the small producer's claim for an increase in rate to the contract level for the entire period, although a lower rate was in effect under its filed rate schedule.

Finally, the retroactive application of small producer certificate orders is also unfair and inequitable in that there is no way in which the pipeline can "track" retroactively the effect of the retroactively-imposed obligations.

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VI

In addition to the foregoing, the following problems are also involved in Order No. 428:

(a) At pages 4 and 14 of the order, the Commission provides that the exemption will not apply to a small producer jurisdictional sale where the gas reserves related thereto "were acquired by the *purchase* of developed reserves in place from a large producer." The Commission should clarify the scope of the word "purchase." For example, should a small producer acquire reserves from a large producer by means other than a "purchase," (gift, devise, "swap," etc.) would the small producer exemption apply to a subsequent jurisdictional sale?

(b) The meaning of the word "developed" as used in the above restriction is unclear. For example, one well may be sufficient to indicate "developed" reserves in some areas, while many wells may be required in other areas.

(c) Also unclear is whether small producers, as assignees of interests in a large producer's gas producing properties covered by certificated rate schedules, are to comply with Sections

154.92(d)(1)(2)(3) and 157.24 of Regulations which provide for filings by the assignees for authority to continue a sale from properties which are dedicated to a pipeline purchaser.

(d) It is unclear (1) whether the filing for a "separate certificate authorization" by a small producer to cover a jurisdictional

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sale of gas acquired from a large producer will be necessary if the sale from the properties has already been certificated, and (2) whether it is intended that the Commission's rate regulations apply to the sale.

(e) Assuming that a given "developed" reserve sale transaction from a small producer to a large producer is non-jurisdictional, the economic effect of such a transaction would appear to force the ultimate sale of such reserves by the large producer to a non-regulated market. This is because of the need that the large producer secure a price sufficient to recover the payment made to the small producer, plus its necessary profit margin. The Commission should indicate the effect it anticipates in such situations as to the ultimate availablity of gas to the interstate market.

(f) It is unclear whether, when a small producer sells dedicated "developed" reserves in place to a large producer, the large producer will be required to sell at a regulated price, rather than the previously effective exempt price. If the large producer must sell at a *lesser* regulated price, the Commission should indicate the economic effect that such a result would have on future lease trades, sales, *etc.*, between small and large producers in terms of further development of new reserves for commitment to the interstate market.

(g) The Commission should specify whether small producer warranty-type or spots sales involving no particular reserve dedication would be exempt if the reserves actually used for such sales were acquired in part from a large producer.

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(h) Under Order No. 428, a small producer owning a gas reserve jointly with a large producer could commence sale without specific certificate authorization long before the large producer could obtain certificate authority from the Commission. It is unclear whether it would be permissible for the large producer's interest (assuming an interest in excess of 12½ percent) to be sold under the small producer's contract pending Commission determinations respecting the large producer's certificate application.

(i) It is unclear whether small producers will be governed by the outcome of the AR61-2, AR69-1, *Southern Louisiana* area proceeding as to refund liabilities, particularly if the UDC settlement proposal is adopted.

(j) It is unclear, particularly in view of the findings at page 4 of the order, whether large producers are to be permitted to use "flexible" pricing clauses in their contracts, other than those allowed by Section 154.93 of Regulations, in order to reflect small producer increases.

(k) It is unclear whether large producers will be entitled to file rate changes in excess of contract levels in order to reflect small producer increases without first securing Commission authorization under Section 5 of the Natural Gas Act.

(l) Order No. 428 contains no showing of the factual and legal basis under *Mobile* (350 U.S. 332) and *Sierra* (350 U.S. 348) standards for the predetermination in the footnote on page 9 that small producers may

"file for" the "minimum" rate authorized in any area.

(m) The requirement that pipelines file all "new" contracts, contract amendments, and notices of cessation of deliveries relating to small producer sales is improper and unlawful. There is nothing in the Notice of Proposed Rulemaking that such filing requirements would be imposed upon the pipelines. Moreover, the filing requirements are contrary to the provision of Section 4 and Section 7 of the Natural Gas Act, relating to the Commission's authority to require filings and applications by "natural gas companies."

(n) There is no indication in Order No. 428 as to the basis upon which the Commission intends to ascertain the "prevailing price differential in the area" in determining the propriety of "large" producer increases.

WHEREFORE, for the foregoing reasons, it is respectfully submitted that the Commission should grant rehearing with respect to Order No. 428 issued in the above proceeding on March 18, 1971 and, upon such rehearing, to vacate that order.

Respectfully submitted,

TENNESSEE GAS PIPELINE COMPANY,
A DUVISION OF TENNECO INC.

*Of Counsel*

By /s/ Melvin Richter

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April 16, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

EXEMPTION OF SMALL PRODUCERS )
FROM REGULATIONS ) Docket No. R-393

APPLICATION OF WARREN PETROLEUM CORPORATION
FOR REHEARING AND RECONSIDERATION
OF ORDER NO. 428

Now comes Warren Petroleum Corporation (Warren) and, pursuant to Section 19(a) of the Natural Gas Act and Section 1.34 of the Commission's Rules of Practice and Procedure, and files this application for rehearing and reconsideration of Order No. 428 issued by the Commission in the above docket on March 18, 1971.

The person upon whom service of pleadings, documents or communications with respect to this matter should be made is as follows:

Warren M. Sparks
Warren Petroleum Corporation
P.O. Box 1589
Tulsa, Oklahoma 74102

In support of this application, Warren would show the following:

I.

By Notice of Proposed Rulemaking issued on July 23, 1970 in Docket No. R-393, the Commission proposed to exempt from regulation and under the Natural Gas Act all existing and all future jurisdictional sales made by small producers. Small producers were defined for this purpose as being producers whose jurisdictional sales on a nationwide basis,

together with such sales of affiliate producers, are not in excess of 10,000,000 Mcf in a calendar year, exclusive of sales made pursuant to percentage sales contracts. Under the Commission proposal as noticed, the small producer could file for a blanket certificate which would exempt the small producer from

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all provisions of the Natural Gas Act and the Commission's Regulations, otherwise applicable to jurisdictional sales covered by such exemptions, except for the requirement that the small producer submit annually a document setting forth its volume of jurisdictional sales. Although the Commission's Notice indicated that the proposed exemption for small producers would include, *inter alia*, jurisdictional sales made by small producers to a large producer, and that the resale of such gas by the large producer, would remain subject to Commission jurisdiction, it did not indicate that large producers would be required to take the risk of their contract differential being consistent with "prevailing price differentials in the area" and of the small producer price not being "unreasonably high." The Commission's Notice is fatally defective because it did not indicate that Warren, as a large producer, would have to bear these risks of subsequent Commission action rejecting its contract prices with small producers without recourse to reimbursement from the small producers by way of refunds. Warren did not file comments on this proposal as noticed, believing none were required, but hereby submits that Order No. 428 went beyond the scope of the rulemaking notice to the detriment of Warren, and that rehearing or reconsideration of this order should be granted.

II.

Without regard to the sufficiency of the Notice, the Commission's exemption of the small producer from price regulation, while at the same time imposing on Warren as a large producer the risk of the Commission's rejection of the price to be paid the small producer, is beyond the power of the

Commission under the Natural Gas Act. If the Commission is going to permit the small producer to exact his contract price from a large producer free of Commission regulation, the Commission cannot deny the large producer the

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right to pass on his higher cost to his purchaser. The Order, as written, is unreasonably discriminatory and preferential as between large and small producers and is in violation of Section 4 of the Natural Gas Act.

III.

Warren, as a large producer, will be faced with the further problem of purchasing gas which must be resold under old contracts which contain prices that are not competitive with the existing market values. Many old contracts obligate the large producer to deliver any new gas he may purchase at the price in the old contract. In such instances, a large producer will either be limited in what it can pay to the non-competitive prices in a contract executed many years before, or will have to absorb the loss. The only other alternative would be to leave existing facilities (processing plant) half used and build new ones that can command a new competitive price. Order No. 428 recognizes the desirability, if not the necessity of according non-discriminatory treatment to pipelines and large producers with respect to the purchase of gas from small producers. However, the Order, as written, places a large producer at a distinct disadvantage since a pipeline is not limited in the price it can pay by its sales contract and may negotiate any price at the risk only of such price being found to be unreasonably high. This aspect of the Order is unreasonably discriminatory against the large producer. This discrimination would be eliminated by permitting the large producer to pass on his additional cost and maintain his sales margin, regardless of contract limitations.

WHEREFORE, in consideration of the above, Warren urges the Commission to grant rehearing and that it modify Order No. 428 so as to eliminate the errors and inequities which

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will occur as a result of the

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exemption of small producers in the manner prescribed by the order.

Respectfully submitted,

/s/ Warren M. Sparks
Warren M. Sparks
Attorney for
Warren Petroleum Corporation

April 13, 1971

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

| | | |
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| Exemption of Small Producers From Regulation | ) ) | Docket No. R-393 |

APPLICATION OF
CONSOLIDATED GAS SUPPLY CORPORATION
FOR REHEARING, RECONSIDERATION
AND MODIFICATION

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Filed: April 19, 1971

*Designated, pursuant to FPC Order No. 424, to receive service. It would also be appreciated if service might be made on Henry P. Sullivan.

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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL POWER COMMISSION

| | | |
|---|---|---|
| Exemption of Small Producers From Regulation | ) ) | Docket No. R-393 |

APPLICATION OF
CONSOLIDATED GAS SUPPLY CORPORATION
FOR REHEARING, RECONSIDERATION
AND MODIFICATION

Consolidated Gas Supply Corporation (Consolidated Supply), being aggrieved by the Commission's Order No. 428 issued herein on March 18, 1971, as amended and supplemented by its Order No. 428-A issued on April 9, 1971, hereby files its Application for Rehearing, Reconsideration and Modification, pursuant to Section 19 of the Natural Gas Act (15 U.S.C. 717r) and Section 1.34 of the Commission's Rules of Practice and Procedure (18 CFR 1.34). In support hereof, Consolidated Supply shows the following:

I

Consolidated Supply is an operating subsidiary of Consolidated Natural Gas Company, a registered public utility holding company, and is a natural gas company within the meaning of the Natural Gas Act, subject to the Commission's jurisdiction thereunder. Consolidated Supply and its affiliates comprise the Consolidated Natural Gas System, which serves market areas in New York, Ohio, Pennsylvania and West Virginia. Consolidated Supply, which is the principal supply arm of the Consolidated System, depends for a relatively small but, nonetheless, substantial and critically-important portion of its gas supplies

upon contracts with small producers, as defined in the Regulations promulgated by Order No. 428, particularly in the Appalachian Area.

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Consolidated Supply, having a vital interest in the rulemaking involved herein, on September 15, 1970, filed its Comments and Recommendations in response to the Commission's Notice of Proposed Rulemaking dated July 23, 1970, and actively participated in the conference held on December 8, 1970, in this proceeding, urging that the regulations proposed be modified as follows:

*First:* Small producers should be exempt from certificate and rate regulations only to the extent that their small-producer sales are made at rates not in excess of applicable ceiling guideline rates or just and reasonable area rates, if the latter have been determined for the area, subject to a provision for petitioning for amendment or waiver permitting higher prices, as suggested in the Commission's Notice of Proposed Rulemaking issued October 16, 1969, and later provided for by the Commission's Order No. 411, as amended by Order No. 411-A, issued October 2 and 30, 1970, in Docket No. R-371, prescribing area rates for the Appalachian and Illinois Basin Areas;

*Second:* Small producers should be exempt from compliance with Section 7(b) of the Natural Gas Act with respect to the abandonment of their small-producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment; and,

*Third:* Annual statements by small producers should be expanded to show (in addition to the volumes of annual sales) by areas and jurisdictional purchasers the volumes sold and the prices charged (including what part, if any, constituted production or severance tax reimbursement).

II

The third suggestion above was adopted, in effect, by the Commission's Orders Nos. 428 and 428-A herein. As to the second suggestion, the Commission, in Order No. 428, indicated its intent to retain control over all abandonments,

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yet left in effect Section 157.39 of its Regulations which exempts small producers from its abandonment regulations altogether.

The first suggestion was, for all practical purposes, rejected by the Commission in Order No. 428. Therein, the Commission provided for issuance of blanket certificates to small producers under which they are authorized to make sales nationwide pursuant to existing and future contracts at the prices specified in each such contract with a limited exception, namely, contracts containing favored-nation, price-redetermination and spiral-escalation clauses. The filing of contracts containing such clauses executed on or after April 2, 1962, has been proscribed (Order No. 242, 27 FPC 339); however, the Commission, in Order No. 428 herein, now provides that the clauses may be used to the extent the resulting rate does not exceed the applicable area just and reasonable rate ceiling, or, where none is available, the applicable area guideline initial rate ceiling.

Additionally, without any notice, the Commission surprisingly provides that sales by small producers, from and after May 2, 1971, will be regulated at the pipeline level by the Commission's reviewing the purchased gas costs of each pipeline with respect to small-producer sales. As the Commission, in Order No. 428, states (p. 8):

> "Small producers will have no refund obligations with respect to increased rates, if any, collected for

sales regulated hereunder to pipelines, and, as a result, pipelines will receive no refunds from small producers to flow through. However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in

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(1) a pipeline rate case or (2) a proceeding involving only the tracking increase. Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. The Commission shall consider all relevant factors. See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Austral Oil Co.* v. *F.P.C.*,______F.2d______ (Fifth Circuit 1970, slip opinion dated March 19, 1970, No. 27492, *et al.*) In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests."

III

The Commission erred in adopting and issuing Order No. 428 of March 18, 1971, as amended and supplemented by Order No. 428-A of April 9, 1971, in that the findings, conclusions and ordering provisions thereof are contrary to law, as they fail to meet the requirements of the Natural Gas and

Administrative Procedure Acts (15 U.S.C. 717-717w; 5 U.S.C. 551-559; 701-706) or the Constitution of the United States.

The Commission erred in the particulars and for the reasons stated in "Application for Rehearing and Reconsideration of Independent Natural Gas Association of America", filed herein substantially concurrently herewith. All of the specifications of error and supporting reasons stated therein are relied upon by Consolidated Supply and the same are hereby incorporated herein by reference and made a part hereof.

Briefly stated, contrary to the plain statutory mandate contained in Section 4(a) of the Natural Gas Act, the Commission erred in Order No. 428 by not requiring that small producers should be exempt only to the extent that their sales are made at rates not in excess of applicable ceiling guideline or just and reasonable area rates, as set forth in Consolidated Supply's first suggestion above. Order No. 428, in effect, purports to license small producers to demand and charge rates higher than "just and reasonable" area rates, to wit, rates declared unlawful by Section 4(a) of the Act.

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Moreover, by requiring that pipeline company rates shall be subject to reduction and refund insofar as the prices paid to small producers exceed "the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area", the Commission has, in effect, unfairly and unlawfully shifted the burden of determining just and reasonable rates to be paid small producers to the pipeline companies. To add to the pipeline companies' dilemma, the Commission has not specified whether the highest price paid to large producers *or* the prevailing intrastate price is to fix the ceiling rate which pipeline companies may safely pay, nor has the Commission attempted to define such crucial terms as "prevailing market price" or "producing area".

In short, it appears that, while pipeline companies, in this time of a nationwide gas shortage, must compete vigorously for all available gas supplies, they must not compete too vigorously for fear that their stockholders will be penalized to an indeterminable degree in future rate proceedings through the Commission's disallowance of costs incurred by such companies in their efforts to meet their market requirements.

Certainly, in order to satisfy minimum due process requirements, the Commission must specify with a reasonable degree of clarity the prices which pipeline companies can safely pay for gas purchased from small producers.

IV

Aside from the legality and fairness aspects of Order No. 428, why did the Commission abandon the course of action promulgated by its Order No. 411 issued October 2, 1970, in Docket No. R-371? In that Order, the Commission considered whether contract prices governed by market forces should be relied upon to

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determine area rates in the Appalchian and Illinois Basin Areas, where the great preponderance of sales are by small producers, and concluded that it was not appropriate to do so. In that Order, as amended by Order No. 411-A, the Commission issued certificates to small producers in such Areas without the necessity of rate or certificate filings, with the proviso that any such producer seeking rates higher than the just and reasonable area rates prescribed by the Order must petition for appropriate relief.

It is to be noted that the then newly-promulgated Regulations, to wit, Subsections 157.40(e) and (f), which issued these certificates to the small producers in these two Areas, have been

replaced, and thus repealed, by the instant Order No. 428, without any notice, acknowledgment or explanation.

Order No. 411, in Docket No. R-371, relieved the Commission and the industry of a multitude of filings and burdensome paperwork but, at the same time, defined and limited the prices to be charged by small producers. Now, the instant Order No. 428, without any reference to or acknowledgment of Order No. 411, changes without explanation the well-founded course embarked upon in that earlier Order.

V

Consolidate Supply submits that Order No. 428, as written, requires clarification and modification with respect to the following:

*First Matter for Clarification*

At page 10 of Order No. 428, the Commission states:

> "Producers who have received small producer certificates prior to the issuance of this order, or who have applied and qualify but have not yet received such a certificate, will not be required to file new applications seeking exemption, unless otherwise directed."

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The Order promulgates new Subsections 157.40(e) and (f) as part of the Regulations, replacing Subsections 157.40(e) and (f) as promulgated October 2, 1970, by Order No. 411, which granted automatic certification to many small producers in the Appalachian and Illinois Basin Areas.

This replacement, without any notice, acknowledgment or explanation, of Subsections 157.40(e) and (f) would appear to eliminate the blanket certificate authorizations granted to small Appalachian and Illinois Basin producers, thereby requiring such producers to apply for blanket certificates under new Subsection 157.40(b) prior to May 2, 1971. If this is the case, it should be clearly stated.

*Second Matter for Clarification*

At page 7 of the Commission's Order No. 428, it is stated that "small producers shall be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein", but Section 157.39 of the Commission's Regulations makes the only producer abandonment regulations, that is, Section 157.30, inapplicable to small producers. Section 157.39 of the Regulations is, thus, contrary to the Commission's intent stated in Order No. 428.

In any event, Consolidated would still urge the Commission to adopt the view that the written consent of the pipeline purchaser should be the only prerequisite to the abandonment of a small-producer sale, and that formal applications should be required only where there is a dispute. In a great many cases, the well has been depleted, and there is nothing for the Commission to decide upon the filing of a small producer abandonment application.

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*Third Matter for Clarification*

Some small producers have been receiving increased minimum prices in excess of contract prices since October 2, 1970, without the necessity of filing for such increased prices, by virtue of Subsections 154.107(d) and 154.108(d) of the Regulations promulgated by Order No. 411. Such producers' prices

will revert to the lower contract prices under the new Subsection 157.40(c) if they apply for blanket certificates under the new Subsection 157.40(b), unless the small producers avail themselves of the permission granted in footnote 5 of page 9 of Order No. 428, but not reflected in the new Regulations, to file for the increased rates which were decreed in Order No. 411, to be effective without the necessity for any rate filing.

The question which suggests itself is whether many small producers can trace through this maze of contradictions to find the key, newly-required filing permission granted in a footnote to an Order which is not carried through to the Regulations.

WHEREFORE, in consideration of the above, Consolidated Supply respectfully prays that the Commission:

(1) Grant rehearing herein, reconsider its Order No. 428, as amended and supplemented by Order No. 428-A, and, upon such reconsideration, modify the aforesaid Orders to adopt fully the suggestions made originally in Consolidated Supply's Comments and Recommendations filed September 15, 1970, and renewed herein in the instant Application, or, in the alternative,

(2) Set this proceding for oral argument before the Commission, and,

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(3) Grant such other and further relief as may be appropriate in the premises.

Respectfully submitted,

CONSOLIDATED GAS SUPPLY
CORPORATION

By /s/ NORMAN A. FLANINGAM

NORMAN A .FLANINGAM
Its Attorney

Filed: April 19, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

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| Exemption of Small Producers )<br>From Regulation ) | Docket No. R-393 |

PETITION FOR REHEARING AND FOR STAY OF PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

The Public Service Commission of the State of New York (New York), herewith files its petition for rehearing of the Commission's Order No. 428 issued on March 18, 1971. For the reasons set forth below, New York believes the Commission's Order must be set aside and the proceeding terminated. In addition, in view of the nature of the small producer problem involved herein, it is essential that the Commission take prompt action to stay the effect of its order of March 18, 1971 to ensure that it will not become effective until at least thirty days after the Commission action on rehearing.

1. The Commission's decision in Order No. 428 to relieve small producers of all obligations under Sections 4, 5 and 7 of the Natural Gas Act is without legal justification. The special provisions for small producers approved by the Supreme Court in the *Permian Basin Area Rate Cases,* 390 U.S. 747, 786-7, were directly tied to the just and

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reasonable area rates for all producers established therein, and the small producers themselves were held responsible for any

deviations therefrom.[1] Under such circumstances the Supreme Court held that "the exemptions created by the Commission for [the small producers] are fully consistent with the terms and purposes of its statutory responsibility." Here, however, the Commission's scheme ties the propriety of the rate received by small producers to the unregulated field prices for interstate or intrastate sales, (but see *City of Detroit v. FPC,* 230 F.2d 810 (CADA, 1955) *cert denied,* 352 U.S. 829), and the small producers are even relieved of the obligation for complying with such standard. This is not a proper classification of small producers for separate regulation *within* the Natural Gas Act pursuant to the provisions of Section 16 of the Act, but *pro tanto* deregulation for which there is no statutory authority.

2. The Commission has not found, and on the basis of the filings in this proceeding or any other evidence or information of which it could take official notice could not find that the just and reasonable

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rates for the not inconsequential percentage of sales by small producers in interstate commerce[2] are either the "highest contract prices for sales by large producers" or the "prevailing market price for intrastate sales in the same production area." Just such a test has been declared to be improper even for fixing permanent certificate prices *pending* determination of just and

[1]The one permitted deviation from the area rate—the inapplicability of the quality adjustment provisions to small producers—was upheld by the Commission and the Court as having a *de minimus* effect.

[2]The 10.52% figure for small producer sales given in the body of the Commission's order underestimates the total percentage of sales which would be effectively deregulated. As the footnotes indicate, the figure does not include the substantial amount of gas originally sold to large producers and resold to pipelines.

reasonable rates. See, e.g., *Public Service Commission of the State of New York* v. *FPC*, 361 U.S. 195 (1959), summarily reversing 269 F.2d 865 (C.A. 3); *Public Service Commission of the State of New York* v. *FPC*, 287 F.2d (CADC, 1960), *cert. denied*, 265 U.S. 880, 882. Commissioner Carver's recent statements as to why producer deregulation is peculiarly inappropriate in the present period of gas shortage is just as applicable to the substantial amount of gas sold by the small producers as to large producer sales. And, let there be no misunderstanding; under the Commission's test the limitations on the prices for these sales which the Commission purports to be indirectly imposing through its regulation of the purchasers, is almost entirely form rather than substance.[3]

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3. In any event, regulation of the purchaser's rates is not an adequate substitute for regulation of sales subject to the Commission jurisdiction. See *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 681-683; compare *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, affirming 29 FPC 256. ("Control limited to approving the costs of the gas to the purchasing pipeline is, of course, not an effective way to regulate producer prices because in the large a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities.")

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[3]The retention of Section 7(b) abandonment jurisdiction is useful, but not relevant to the price problem. The limitation on the use of indefinite escalation clauses is of minimal significance. And the elimination from the exemption of sales by small producers where they acquired developed reserves in place from large producers, while an improvement on the original proposal still permits much too much trafficking in leases to avoid regulation, particularly since there is no definition of "developed reserves."

4. Even if there was some legal and factual basis for abandoning all effective rate regulation under the National Gas Act for future sales of natural gas by small producers, there could be none for the Commission's actions in applying its *de facto* exemption scheme to flowing gas. Specifically there has been no showing that small producers desiring to remain in the gas production business will not have, or be able to secure, adequate funds to conduct production operations pursuant to appropriate just and reasonable area rates, to say nothing of a higher, unregulated price for their new gas sales. At the same time it is evident that many of the small producers will merely pocket the extra compensation received for such flowing gas sales; many of the existing small producer sales freed from effective regulation by this order are made by entities which are no longer

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in the business and have no intention of re-entering it regardless of the Commission's action herein.

5. The provisions of Section 157.40(d) of the rule relating to the duration of the exemption are well calculated to breed avoidance of the proposed 10 million Mcf per year limitation.[4] The small producer keeps his exemption until the Commission "on its own motion or on application" issues an order terminating it, and all sales made prior to termination, including those which brought its sales above the cutoff limit, and those made subsequently, are blanketed into the exemption. Since there is no requirement that the producer file an application to terminate the status from which he benefits, he

[4]The rule contains no factual predicate for the Commission's unexplained action in choosing 10 million mcf per year as the dividing line between small and large producers. The fact that this figure has been utilized in other proceedings which did not involve *de facto* deregulation of small producer sales does not, of course, necessarily make its use appropriate here.

certainly will not do so. As a consequence, we have a system where the Commission will receive a mass of small producer reports on April 15th of each year from which it may be in a position subsequently to institute termination proceedings. It is evident that the slippage will be severe.[5]

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6. It seems clear that, as a minimum, the Commission should provide for an automatic termination of the exemption as of the time the cutoff figure is reached, with any formal Commission termination order operating retrospectively thereto. Also, it would seem that the annual small producer report should constitute an application for termination where it indicates the limit has been reached.

7. The Commission is rightly concerned about the effect of its rule upon plant sales by large producers. For one thing, the rule is bound to discourage future percentage sales, except by small producers otherwise in jeopardy of losing their exemption. This is unfortunate, since the percentage sale device seems a particularly appropriate one from the standpoint of both consumer protection and the best interests of the plant operator. (It also is a device which frees the small producer from all administrative burdens.) If, as a result of the Commission's unfortunate action, plant costs may be raised to a level which would justify an adjustment from the area rate for

[5] Theoretically, the Commission staff will be in a position to institute termination proceedings at an earlier date as a result of its perusal of the mass of small producer contracts which pipelines and large producers are required to file under subsection (g) of the rule. In practice, we suggest that this filing requirement, except for its possible cosmetic effect, will merely serve to impose an unnecessary burden upon the purchasers. However, the requirement points up the fact that the non-regulatory system established by the Commission's rule, if it were to be enforced by the Commission's staff, would be at least as burdensome as the one it is intended to replace.

such producers, some form of procedure for seeking relief will necessarily have to be provided. But there is no justification whatsoever for the procedure incorporated into subsection (f) of the new rule. As examination of the discussion of plant sales in the Commission's Permian and Southern Louisiana area rate cases will show, the proper pricing of such sales is a most complex and controversial subject. Assuming that

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some of the seller s purchased gas costs are increased by the Commission's action in this docket, it by no means follows that any increase in the plant sale rate will be justified as a result. And certainly the test of whether any increase is justified cannot properly be whether "the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area." Since the Commission's order does not explain what is meant by the term "prevailing price differential in the area" it is not possible to know the exact scope of the standard which seems to be based on the erroneous concept that there is a one-to-one relationship between a small producer's sale to the plant operator and the latter's resale to a pipeline. In any event, it is clear that the ability to meet any such standard can justify acceptance of a rate increase filing without refund obligation.

8. In our opinion the most which is appropriate by way of relief to plant operators from the effects of the Commission's rule would be to provide an exemption to any moratorium on rate increase filings above the just and reasonable area rate where a large producer plant operates can show that its purchased gas costs have increased by more than 10% as a result of the Commission's rule. Any such filings which the Commission might permit would be suspended and subsequently allowed to become effective only subject to refund. And increases in plant operator rates above the just and reasonable area rate would be justifiable only where giving

consideration to all of the various components going into the establishment of such rates, it can be shown that the area rate is no longer appropriate.

9. Commission Order No. 428 by its terms is effective 45 days from its issuance, which shall undoubtedly be before it acts on this and other petitions for rehearing. We need not belabor the point as to the difficulties of unscrambling this particular egg, should the Commission permit the rule to become effective and then on rehearing rescind or substantially modify it. The same situation would apply after any Commission order on rehearing with respect to possible court appeals therefrom. We therefore believe the Commission must promptly announce that the effectiveness of its order will be stayed until at least 30 days after its decision on rehearing.

Accordingly, New York requests the Commission to grant rehearing and, upon its further consideration of the matter, set aside Order No. 428 and terminate rulemaking Docket R-393. The Commission should also immediately take action to toll the effective date of the order until at least 30 days after its opinion on rehearing.

Respectfully submitted,

Public Service Commission of the
State of New York

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

| | | |
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| Exemption of Small Producers | ) | Docket R-393 |
| From Regulation | ) | |

## APPLICATION BY PHILLIPS PETROLEUM COMPANY FOR A REHEARING OF ORDER NO. 428

COMES NOW Phillips Petroleum Company (Phillips) pursuant to Section 19 of the Natural Gas Act and Section 1.34 of the Federal Power Commission (Commission) Rules of Practice and Procedure and Petitions for Rehearing and Reconsideration of the Commission's Order No. 428 "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements", issued March 18, 1971.

I.

Under Docket No. R-393 "Exemption of Small Producers from Regulation" the Commission on July 23, 1970, issued Notice of Proposed Rulemaking. Phillips was one of the parties that submitted views, comments and suggestions to the Commission within the time allotted by said Notice for such comments, views and suggestions, and Phillips participated in the conference held in this case on December 8, 1970.

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Order No. 428 permits a producer whose total jurisdictional sales of natural gas are not in excess of 10,000,000 Mcf per year ("small producer") to secure a blanket certificate covering all existing and all future jurisdictional sales and to retain same until its total annual jurisdictional sales do exceed 10,000,000

Mcf. During the period such blanket certificate is in effect said small producer is authorized to make sales of gas pursuant to existing and future contracts at the prices provided by such contracts without refund obligation and without the necessity of filing for or receiving authorization therefor by the Commission.

II.

Order No. 428 is unlawful because:

1. Order No. 428 is at substantial variance in terms and substance with the Notice of Proposed Rulemaking and therefore violates the provisions of Title 5 USC 553.

2. The Commission has no statutory authority to exempt totally a class of producers from operation of the Natural Gas Act.

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3. Order No. 428 is patently discriminatory against Phillips in particular and other large producers in general in violation of Section 4(b) of the Natural Gas Act.

III.

The Proposed Rulemaking of July 23, 1970, was titled "Exemption of Small Producers from Regulation" and the justification and rationale set forth in such Proposed Rulemaking were directed toward this end. Conversely, Order No. 428 at page 4 of the body thereof disavows any deregulation of sales by small producers.

Perhaps sensing in part the futility of attempting to exempt totally a segment of the producing industry from regulation under the Act, the Commission seeks to forestall this by

shifting the burden of regulation from the small producers to the pipelines. Such indirect regulation, which is arguably beyond the scope of the Act, is certainly and without question beyond the scope of the Notice of Proposed Rulemaking of July 23, 1970. At page 4 of Order No. 428 it is stated that the Commission "will continue to regulate such sales, but will do so at the pipeline level by reviewing

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the purchase gas costs of each pipeline with respect to small producer sales." The Order thus introduces a new scheme and concept of indirect regulation which is outside the terms and substance contained in the Notice of Proposed Rulemaking thereby depriving Phillips of the Notice thereof and opportunity to comment thereon in violation of Section 553 of the Administrative Procedures Act.

Order 428 varies further in terms and substance from the Notice of Proposed Rulemaking in that said Notice was totally silent with respect to the inclusion of the royalty interest within the proposed exemption, whereas, at page 6 of Order 428 the Commission states that "if a royalty interest relates to a small producer sale, such interest shall be exempt . . .". As stated in the comments of Mobil Oil Corporation filed in response to the Notice of Proposed Rulemaking in making this very point, "the exemption of sales by royalty owners cannot logically be deemed 'minimal' in its impact upon producers . . .".

The Commission purports to find authority for the action undertaken by Order No. 428 in the language

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of Justice Clark in *FPC* v. *Hunt*, 376 US 515 (1964) and the recognition in the *Permian Basin Area Rate Cases*, 390 US 747 (1968) of the power of the Commission under Section 16 of the Natural Gas Act to "classify persons and matters within its

jurisdiction and prescribe different requirements for different classes of persons or matters." There is nothing in Section 16 which would grant the Commission power to classify persons in such a manner as to remove them totally from the clear requirements of the Act, and while Section 16 allows the Commission to classify for purposes of its rules and regulations, by no reading can it be construed to grant to the Commission the power to exempt any person from the mandatory language of Sections 4 and 7 of the Act. Section 4(a) states in part that "*all* rates and charges . . . by *any* natural gas company . . . shall be just and reasonable" and Section 4(c) states that ". . . *every* natural gas company shall file . . . *all* rates and charges for any . . . sale subject to the jurisdiction of the Commission . . .". Section 7(c) of the Act provides that "*no* natural-gas company . . . shall engage in the . . . sale of natural gas, subject

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to the jurisdiction of the Commission . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations . . .". The Commission itself in Order No. 174-b, 13 FPC 1576, 1577 (1954) in response to the urging that the regulations be amended to relieve small producers from the requirements of the statutes stated "the Act does not provide for exemptions from its requirements . . .". This, it is submitted, is clear recognition by the Commission itself that the authority to classify does not in and of itself include the power to exempt.

The Commission has sought for years to come to grips with the task of regulating independent producers. What is there for it to regulate? Certainly, it is not going to regulate the spacing or depth of wells nor such. It is to regulate the price and service by such producers. With one fell swoop the Commission deregulates a segment of the industry and throws to the winds the sacrosanct concept of just and reasonable rates by such segment. Phillips submits that any

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standard by which the price at which it sells its gas is held to a level which the Commission deems to be "just and reasonable" for Phillips while at the same time gas perhaps from even the same well is free to be priced in accord with the realities of the market is no standard at all, but is an unlawful, arbitrary and capricious classification.

In its initial comments Phillips warned of the situation which could be created by the proposed exemption and the resultant above-ceiling prices received by small producers in light of some recent court decisions. The Supreme Court of Texas in the case of *Texas Oil and Gas Corporation* v. *Vela*, 429 SW 2d 866 (1968) stated that the royalty payments to be made on the basis of "market price" under the terms of the lease were not controlled by the price received under the contract by which the gas was sold, but, rather, that "market price" was to be determined by sales of gas comparable in time, quality and availability to marketing outlets in addition to the particular contract. Under the facts in the *Vela* case the working interest owners selling gas under 1935 contracts for

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2.3¢ per Mcf were required to pay royalty on the basis of 13¢ per Mcf which was determined to be the "market price" prevailing in the field. The Commission's Order No. 562, 42 FPC 164 (1969) holding that royalty provisions of oil and gas leases constitute sales by the royalty owners for resale in interstate commerce and are thereby subject to the Commission's jurisdiction mollified to some extent the effect or application of the *Vela* case in that the Commission provided that the payments of royalties should be made as provided in the lease except that same should not be calculated on a value higher than the just and reasonable rates fixed by the Commission. Those producers now exempted by Order 428 from regulation who might have a

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low price contract such as existed in the *Vela* case now find themselves with the ceiling having been removed and "market price" royalty payments conceivably being due upon an amount in excess of the area ceiling. Furthermore, this facet of Order 428's operation will operate to discriminate against large producers in that knowledgeable royalty owners quite likely will refuse to

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grant oil and gas leases to large producers preferring to reap the advantages of unrestricted sales by small producers.

In states such as Oklahoma where severance taxes are collected on the basis of "value" of gas production, the exemption granted by Order No. 428 will very likely increase the tax burden of both the exempted producers and unlawfully discriminate against the unexempted producers. Gas evaluated on the basis of the highest price being paid in the field or area in which it is produced will automatically be assigned a value commensurate with the higher prices being collected by the exempted small producers in that field or area rather than the regulated ceiling prices applicable to the nonexempted large producers in the same field or area.

Phillips pointed out in its comments filed in response to the Notice of Proposed Rulemaking that the rule as proposed seemed designed to drive Phillips from the business of extracting natural gas liquids from purchased gas. Order No. 428 confirms this discriminatory design, and it cannot be masked by the

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exclusion of percentage sales contracts from its operation nor by the provisions of ordering paragraph (A) 1 (f). Certainly no rational small producer is going to make a nonexempted sale to Phillips or other producer-plant operator at a percentage of the

ceiling price when he can sell his gas to an interstate pipeline at prices well above the ceiling plus liquid values. This is particularly true when the volume covered by such percentage sale, if made, would be included in the annual computation to determine whether such small producer has exceeded 10,000,000 Mcf and thereby lost his exemption.

Order No. 428 is patently discriminatory in that it gives to the pipeline purchasers a distinct advantage over large producers in the competition for the purchase of gas from small producers. The ordering provisions of the Order are silent with respect to the Commission's acceptance and/or suspension of tracking increases filed by pipeline purchasers to reflect increased prices paid to small producers under new or existing purchase contracts. In the body of its Order, however, the Commission states that ". . . the pipeline's

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rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." In comparison, ordering paragraph (A) 1 (f) provides that "a large producer may file for the *price specified in its related contract* for the resale of any natural gas sold to it by a small producer pursuant to the exemption authorized hereunder. Any such rate filing shall be accepted *if the price differential between the purchase and resale price does not exceed the prevailing price differential in the area,* and if the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area" (emphasis added). A pipeline purchaser may, therefore, increase its resale rates without contractual restriction or any limitation based

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upon the prevailing price differential between the purchase and resale prices existing in the

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area. On the other hand, a large producer may not file for or collect a resale rate that is higher than that provided in its resale contract. Further, even if such resale is permitted by contract, the filing for such rate will be accepted only if the differential between such rate and the purchase price paid to the small producer does not exceed the prevailing price differential in the area. Because of the price limitations in its present resale contracts, Phillips will not be able to compete with pipelines for the purchase of small producer gas to supply its systems and plants and resell such gas under existing contracts. The only remedy available to Phillips will be to resell such gas in intrastate commerce or to make a new jurisdictional contract with its purchaser covering each new incremental supply of gas purchased from small producers. Even with the latter alternative the large producer remains at a bargaining disadvantage compared to the pipeline because of the filing requirements applicable to the large producer. A pipeline may negotiate a purchase contract with a small prodicer at the going market price in the area and commence accepting

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deliveries under budget type arrangements immediately upon the completion of the necessary facilities to connect such gas into its system. In contrast Phillips may offer the producer identical contract terms, but before it can accept deliveries it will be required to (1) negotiate a new resale contract with its pipeline purchaser (who will be a reluctant buyer if it is competing for the purchase directly from the producer); (2) file such new contract with the Commission, together with a certificate application for authority to resell such gas; and

(3) await Commission action with respect to said certificate application.

The Commission is urged to eliminate this preferential treatment afforded pipeline purchasers on rehearing by removing the limitations imposed on large producers which do not permit them to compete effectively for small producer gas supplies at prices as high as those that pipelines are permitted to pay by permitting large producers to enter into purchase contracts with small producers and after commencement of delivery to an interstate pipeline advising the Commission of such purchase and resale thus permitting such large producers

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to purchase volumes of gas from small producers and commence deliveries immediately to pipelines pending certification proceedings. This procedure would be analogous to the budget type arrangement of the pipeline purchasers. Additionally, a large producer should be permitted to resell gas purchased from a small producer, before or after processing, at prices sufficient to maintain the same differential that has heretofore been established between purchase price and resale price of gas sold at a plant or in the general area.

IV.

Wherefore, for the above reasons, Phillips submits said Order No. 428 is unlawful, inequitable and unduly discriminatory against it and requests that the Commission grant rehearing and reconsideration of its Order No. 428.

Respectfully submitted,
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April 16, 1971

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Exemption of Small Producers )
From Regulation ) Docket No. R-393

AMENDMENT TO APPLICATION BY
PHILLIPS PETROLEUM COMPANY
FOR A REHEARING OF FPC ORDER NO. 428

Comes now Phillips Petroleum Company (Phillips), pursuant to Section 1.11 of the Commission's Rules of Practice and Procedure, and tenders this amendment to supplement its application for rehearing of FPC Order No. 428 which was filed with the Commission on April 19, 1971, in the captioned proceeding.

I.

In said application for rehearing, Phillips attempted to point out to the Commission the discriminatory nature of said Order No. 428 in that pipeline purchasers are granted preferential treatment to the detriment of large producer purchasers of gas from small producers. At the time of the preparation and filing of said application for rehearing, Phillips could only refer to the advantageous position of a pipeline company in competition with a large producer for the purchase of a small producer's gas supply and predict the result of such uneven competition. Phillips explained that, because of the limitations in its present resale contracts, it will be unable to compete with pipelines for the purchase of small producer gas to supply its systems and plants and resell such gas under existing jurisdictional sales contracts.

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However, in the short period of time since the issuance of Order No. 428 and even before the effective date of May 2, 1971, provided by said Order,

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the pipeline's competitive advantage and the untenable position of the large producer is now evident and Phillips's prediction of its inability to compete with a pipeline for the purchase of small producer gas supplies is now a demonstrable fact.

By Farmout Agreement dated September 25, 1970, Phillips assigned to Apex Oil Company, predecessor in interest to Bonray Oil Company (Bonray), certain leases in the West Sharon Area, Woodward County, Oklahoma, for development. Said Agreement, as amended by Letter Agreement dated October 29, 1970, reserved to Phillips the right to meet any bona fide offer received by Bonray, as to price and volume, for the purchase of gas well gas produced from such assigned properties. Such reservation is limited to a period of sixty days after the receipt by Phillips of such bona fide offer from Bonray.

The farmed out acreage lies within the area committed under the Gas Purchase and Sales Agreement dated April 15, 1970 between Phillips and Panhandle Eastern Pipe Line Company covering the sale and purchase of gas from Phillips' Cimarron Plant in Woodward County, Oklahoma. Said Agreement is on file with the Commission as Phillips' FPC Gas Rate Schedule No. 478. The initial price provided by said Agreement is 21.0 cents per Mcf at 14.65 psia, plus Btu adjustment. However, by its letter-order dated November 27, 1970, the Commission rejected Phillips' Rate Schedule, Rate Change and Quality Statement, which was filed in compliance with Opinion No. 586, and held that the applicable area rate under said Rate Schedule No. 478 is 18.5¢ plus appropriate adjustments. Phillips' petition for reconsideration of said letter-order was

filed with the Commission on December 16, 1970, and is still pending Commission action. Therefore, any offer that Phillips may make to Bonray for the purchase of gas well gas developed



on such farmed out acreage and for connection into its existing Cimarron gathering system must be limited by its resale rate under said Rate Schedule No. 478 to 18.5¢ or, upon reconsideration and approval of Phillips' quality statement, 21.0¢ adjusted for Btu content.

However, by letter dated April 15, 1971, a copy of which is attached as Exhibit "A" hereto, Bonray notified Phillips of an offer made by Northern Natural Gas Company (Northern) on that date for the purchase of gas from Bonray's Snow No. 1 Well located in Section 9-20N-21W, Woodward County, and other lands covered by said Farmout Agreement. The pertinent parts of Northern's offer are for the purchase of 2,000 Mcf per day at an initial price of 25.0¢ per Mcf, adjusted for Btu content above or below 1,000 with a 1.0¢ per Mcf escalation on July 1, 1972 and each five years thereafter.

Thus, although Phillips reserved the right in said Farmout Agreement to meet any bona fide offer for the purchase of such gas (and certainly expected to be in a position to do so), the Commission's Order No. 428 and its letter-order dated November 27, 1970, have destroyed Phillips' ability to compete for such gas for connection into its Cimarron system. Under these Commission determinations, Phillips' resale rate for such gas is limited to 18.5¢ per Mcf, plus Btu adjustment. Obviously then, if Phillips is to meet the offer of Northern, it will of necessity be required to by-pass its Cimarron system and sell such gas to an intrastate market. As a practical matter, Phillips' Rate Schedule No. 478 will be rendered ineffective, if not cancelled, and no gas will be acquired for resale to Panhandle Eastern thereunder.

For the foregoing reasons, Phillips submits that said Order No. 428 is patently unfair and discriminatory against the interests of large producers, and

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if said Order No. 428 is enforced the competitive position of large producers with respect to purchases of small producer gas supplies will be severely crippled. The inevitable result will be the decline of gas supplies for existing plant gathering systems, the construction of new and duplicative systems by the pipeline companies, and the diversion of new gas supplies into the intrastate commerce.

A further result of said Order No. 428 is made obvious by the above. Large producers will be extremely reluctant to farm out properties for development by small producers. In the past farmouts to small production companies has been a common practice in the natural gas industry. Through such farmout arrangements a large producer could achieve rapid development of its properties, without the necessity of investing huge sums of its capital in drilling equipment and expense, with the assurance that it would be able to purchase any gas developed by the assignee at a competitive price. Order No. 428 not only eliminates such assurance, but makes it virtually impossible for the large producer to compete for the purchase of such gas to supply its present resale contract commitments.

Wherefore, Phillips repeats its urgent request that the Commission grant rehearing and reconsideration of said Order No. 428. Phillips further requests that, pending rehearing and reconsideration, the Commission issue an order staying the effectiveness of said Order No. 428.

Respectfully submitted,

PHILLIPS PETROLEUM COMPANY

By /s/ W. M. Williams
Staff Supervisor
Laws and Regulations Division
Gas and Gas Liquids Department

Dated April 29, 1971

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BONRAY OIL COMPANY
1361 First National Building
Oklahoma City, Oklahoma 73102 CE 6-4668

April 15, 1971

EXHIBIT A

Phillips Petroleum Company
100 Park Avenue Building
Oklahoma City, Oklahoma 73102

Attention: Mr. Fred Terry

Gentlemen:

Reference is made to Article XI of that certain Agreement dated September 25, 1970, between Phillips Petroleum Company and Apex Oil Company, later amended by Letter Agreement dated October 29, 1970. Under the terms of the Amendment of October 29, 1970, and accepted by Apex on December 14, 1970, Phillips has the right for a period of sixty days to meet a bona fide offer received by Apex (*succeeded by Bonray Oil Company*) as to price and volume for the purchase

of gas from the lands described in Exhibit "A" of the Agreement dated September 25.

You are hereby notified of the offer made by Northern Natural Gas Company on April 15, 1971, for the purchase of gas from our Snow No. 1 in Section 9-20N-21W and other lands described in your Farmout Agreement. The offer is as follows:

*Price*
25.0¢ per MCF initially with a 1.0¢ per MCF escalation each five-year period commencing July 1, 1972, with upward and downward BTU adjustments from 1000

*Takes*
2,000 MCF per day for the first two years and, thereafter, based on a 1/7.3 ratio

*Prepayment*
The Contract contains a provision for prepayment based on $20,000 for each one BCF of proven reserves with a recoupment rate of 30 per cent of the proceeds due Seller for gas purchased. In the event of premature abandonment or if the entire prepayment has not been recouped at the end of a five-year period, a cash settlement will be made to Northern for the unrecouped amount.

*Take or Pay*
Effective thirty days after the latter of Seller's approval and acceptance of FPC Certificate of Northern's approval of Seller's title.

*Processing*
Seller retains the right to have said gas processed through the Amoco plant.

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*Tax Reimbursement*
Northern will reimburse Seller 87½ per cent of new taxes after effective date of Contract.

The BTU adjustment will add approximately 2.5¢ per MCF and the volume of liquids to be processed through the Amoco plant is estimated to be an additional 1.0¢ per MCF.

Please let us hear from you at your earliest convenience as to your decision regarding your right to meet this offer for the purchase of this gas.

Very truly yours,

BONRAY OIL COMPANY

/s/ R. H. Hefner, Jr.
R. H. Hefner, Jr.
President

RHH/cw

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR 157.39]

Before Commissioners: John N. Nassikas, Chairman
Lawrence J. O'Connor, Jr.
John A. Carver, Jr.
Albert B. Brooke, Jr. and
Pinkney Walker

Exemption of Small Producers )
From Regulation ) Docket No. R-393

ORDER NO. 428-B

ORDER MODIFYING ORDER NO. 428
AND DENYING APPLICATIONS FOR REHEARING

(Issued July 15, 1971)

The Commission in Order No. 428 issued March 18, 1971 (36 F.R. 5598, March 25, 1971) in the above-entitled proceeding established a blanket certificate procedure for small producers. Small producers certificated thereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract.

Applications for rehearing of Order No. 428 were filed by James M. Forgotson, Sr. (Forgotson) on March 31, 1971, Mobil Oil Corporation (Mobil) on April 14, 1971, Texaco, Inc. (Texaco) on April 15, 1971, Phillips Petroleum Company (Phillips) on April 19, 1971, Warren Petroleum Corporation (Warren) on

April 16, 1971, Independent Natural Gas Association of America (INGAA) on April 16, 1971, Kansas-Nebraska Natural Gas Company, Inc. (Kansas-Nebraska) on April 19, 1971, Consolidated Gas Supply Corporation (Consolidated) on April 19, 1971, El Paso Natural Gas Company (El Paso) on April 19, 1971, Tennessee Gas Pipeline Company, A Division of Tenneco, Inc. (Tennessee) on April 16, 1971, and the Public Service Commission of the State of New York (New York) on April 19, 1971. By order issued April 29, 1971, the Commission provided for

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joint consideration of these applications for rehearing.

Some of the large producers claim that Order No. 428 casts a burden on them with respect to purchases from small producers which goes beyond the scope of the proposal in the notice issued July 23, 1970 (35 F.R. 12220, July 30, 1970) in this proceeding and is therefore invalid under Section 4 of the Administrative Procedure Act (5 U.S.C. 553).

In the July 23 notice the Commission proposed to apply Section 157.40 of its Regulations, as revised therein, to sales made by a small producer to a large producer, but not to the resale of such gas by a large producer. Under that approach resales by large producers might have been limited to the rate ceiling and any moratorium prescribed by the Commission in each area, but the notice also specifically directed attention to the possibility of a problem in this regard and invited comments with respect thereto.

As a result of the arguments made by certain large producers in their comments that resales of gas purchased from small producers are entitled to the same treatment as small

producer sales, the Commission in Order No. 428 provided relief to the large producers by permitting them to file for contractually authorized rate increases with respect to such resales, regardless of the ceiling or moratorium which would otherwise be applicable thereto. This modification alleviated some of the problems for large producers inherent in the original proposal, while at the same time providing adequate protection for consumers against unreasonable rates by setting a limitation on the rate level which would be accepted without refund obligation. Our actions, we believe, are in full compliance with the Administrative Procedure Act.

Warren contends it will be faced with the problem of purchasing gas from small producers which must be resold

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under old contracts containing prices that are not competitive with existing market values.* The order, according to Warren, places a large producer at a disadvantage since a pipeline may negotiate any price at the risk only of such price being found unreasonably high. Warren suggests elimination of this problem by allowing the large producer to pass on the additional cost incurred in the purchase of gas from a small producer under a new contract and to maintain its sales margin, irrespective of any price limitation in its resale contract. We have authority to remove contract price limitations under the *Sierra* doctrine.[1]

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*Phillips makes a similar argument in its application for rehearing, and in an amendment to such application for rehearing filed untimely on May 3, 1971, Phillips refers to a specific situation where it is unable to compete with a pipeline purchaser for a small producer sale.

[1] *F.P.C.* v. *Sierra Pacific Power Co.*, 350 U.S. 348.

But, the *Sierra* situation is not presented here. There is, however, nothing to preclude a large producer from renegotiating its resale contract if the purchaser is willing to do so.

Phillips states that even if a large producer is able to negotiate a new resale contract, it is still at a bargaining disadvantage with a pipeline because a pipeline may commence deliveries under budget-type arrangements as soon as a contract is negotiated with a small producer, while a large producer must wait for Commission action on its certificate application to resell gas under a new contract. Phillips urges the Commission to permit large producers to commence deliveries immediately and thereafter to advise the Commission of the purchase from a small producer and the resale of such gas to a pipeline pending action on its certificate application.

We think it desirable to help large producers maintain their competitive position with pipeline purchasers with respect to purchases of gas under new small producer contracts. Large producers, however, should be required to file a certificate application before commencing the resale of gas under a new contract. Consequently, we shall authorize large producers to resell gas purchased from small producers at any time after they have filed a certificate application pending action thereon, but any amounts collected for such resales in excess of the rate authorized in the certificate case shall be subject to refund with interest.

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Mobile claims that Order No. 428 is not clear as to whether the small producer will have a refund obligation on deliveries subsequent to March 18, 1971, where its rate was in effect subject to refund prior to that date or where an above ceiling increase is filed subsequent to that date. The blanket certificate authorized in our order will become effective as of May 2, 1971, at the earliest. Any refund obligation for the period prior to the effective date of a small producer's blanket

certificate will be disposed of in the appropriate area proceeding. Consequently, in both of the situations referred to by Mobil, the small producer's rate will be subject to direct Commission regulation at least until May 2, 1971. However, on and after the effective date of its blanket certificate, the small producer is authorized to collect its contract rate for an existing sale without refund obligation, regardless of the rate on file for such sale prior to the effective date of its blanket certificate and without regard to whether such rate previously was being collected subject to refund.

Suggestions have been made to require small producers to inform their co-owners and purchasers of their status as a small producer. In Order No. 428 small producers were required to serve their purchasers with copies of their applications. Aside from this requirement, we believe large producers and pipeline purchasers are in a better position to acquire and maintain this information as they have been required to do in the past in the Permian, Southern Louisiana and the Hugoton-Anadarko areas. We shall provide some assistance in this regard by appending to this order a list of all small producers who have received small producer certificates or who have applications pending as of April 30, 1971.[2] From time to time we shall update this list.

Small producers who receive blanket certificate authorization are required under Section 157.40(c) to obtain abandonment authorization under Section 7(b) of the Natural Gas Act

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for any sale made pursuant to Section 157.40. This requirement applies to sales to either large producers or pipelines. It also applies upon the expiration of a new or existing sales contract

2 The list does not include small producers operating in the Appalachian and Illinois Basin areas.

which provides for termination after a given number of years as well as prior to the expiration of a contract. Nor does it make any difference whether the purchaser consents to the abandonment. Authorization is required in any event. Footnote 4 relating to abandonment authorization on page 7 of Order No. 428 (p. 5600 of Federal Register Document 71-4044 published at pages 5598-5602 in the issue dated March 25, 1971) is confusing on this latter point and inconsistent with the text on that same page. The words "the pipeline consents to abandonment or" should be deleted from line 4 of that footnote so as to clarify the matter. We shall also modify Section 157.39 of the Regulations (which now provides that Sections 157.23 through 157.30 do not apply to those independent producers who are subject to Section 157.40) to accord with the provisions of Order No. 428. More specifically, we shall make the abandonment provisions of Section 157.30 applicable to small producers covered by Section 157.40.

Consolidated claims there is some confusion as to whether those small producers in the Appalachian and Illinois Basin Areas who automatically received small producer certificates pursuant to Order No. 411 are required to apply for blanket certificates under the new provisions of Section 157.40. They are not so required. As we indicated in Order No. 428, p. 10, small producer certificates previously issued to small producers are deemed to cover as of May 2, 1971 all sales covered under the provisions of Order No. 428. However, any producer initiating service in the Appalachian and Illinois Basin Areas after May 2, 1971, the effective date of Order No. 428, and qualifying as a small producer would be required to file an application for a blanket certificate.

Consolidated also questions whether small producers in the Appalachian and Illinois Basin Areas who have been receiving the minimum rate, without the necessity of filing therefor, in accordance with Order No. 411, in lieu of a lower contract rate, are required as a result of footnote 5 on page 9 of Order No.

428 to make a filing for the minimum

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rate in that area. Those small producers who have been collecting the minimum rate in that area are not required to make any filing. The purpose of the footnote was not to require a filing where none was previously required, but to make it clear that a small producer would be entitled to the minimum rate authorized by the Commission in each area even though it had a blanket certificate.

New York objects to the provisions of Section 157.40(d) pursuant to which a small producer who exceeds the 10 million Mcf annual limitation retains his status as a small producer until the Commission takes action. New York claims the slippage will be severe. They argue that, as a minimum, the Commission should provide for an automatic termination of the blanket certificate as of the time the cutoff figure is reached. This particular provision is the same as that adopted by the Commission in Order No. 308 after the issuance of the *Permian* decision in Opinion No. 468. There have been no problems under this provision thus far. Indeed, there has been only one instance where a small producer certificate was terminated. We also think it better to determine the appropriate cutoff date when action is taken to terminate the blanket certificate. In our view the use of the automatic cutoff date suggested by New York might cause serious problems for a small producer. Moreover, we think the cutoff date should be the date (April 1) small producers are required each year to report the volume of jurisdictional sales made in the prior year.

Forgotson contends the Commission lacks jurisdiction to issue Order No. 428. This position is based on his contention that the Supreme Court's determination in the *Phillips* case[3]

[3] *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954).

that this Commission has jurisdiction over sales

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for resale in interstate commerce by independent producers, while constitutional then, is no longer constitutional.

Forgotson's position is unsound. The Supreme Court as recently as 1968 in the *Permian Basin Area Rate Cases*, 390 U.S. 747, by its affirmance of the just and reasonable rates determined by the Commission in Opinion Nos. 468 and 468-A reaffirmed by implication, at least, its jurisdictional holding in the *Phillips* case.

It has also been asserted that Order No. 428 is defective because the notice did not advise pipelines that their purchased gas costs relating to new small producer sales would be subject to review.[4] Implicit in this argument is the assumption that, in the absence of these provisions in our order, pipelines would be free to make purchases from small producers under new contracts at imprudent prices. With this assumption, we disagree. Ever since the passage of the Natural Gas Act in 1938, pipelines as regulated public utilities have been permitted to include in their cost of service only those operating expenses, including the cost of purchased gas, which are reasonable. While our order placed emphasis on that duty, it did not effectuate any basic change in the pipelines' obligations in this regard. These obligations would exist even if nothing had been said in the order.

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[4]The term "new small producer sale" includes, *inter alia*, gas sold by a small producer pursuant to a contract dated on or after March 18, 1971 which replaces an expired contract or pursuant to a contract amendment dated on or after March 18, 1971, modifying the terms of a contract dated prior to that date.

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Similar objections to the Commission's standard for limiting a pipeline's reduction and refund obligation under a tracking increase are also without merit. The Commission in the July 23 notice proposed to allow pipeline purchasers to file tracking increases of rate increases resulting from the issuance of blanket certificates, but the collection of these tracking increases was to be subject to reduction and refund. In response to Consolidated's claim that the collection should not be so conditioned, the Commission in Order No. 428 modified

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the original proposal so as to limit the reduction and refund obligation of tracking increases to those which reflect small producer prices for new sales above the standard set forth therein.[5] The standard also provides pipelines with a more concrete guide for their future actions than would exist in the absence thereof. Simply put, the Commission wanted the pipelines to know in advance the boundaries within which they could freely contract with small producers.

Both INGAA and Tennessee object to the provision which limits tracking increase filings to those situations where small producer rate increases, or such increases together with other increases authorized for tracking, affect a pipeline's cost of purchased gas by one mill or more. INGAA urges that a minimum dollar amount be fixed for each company, or, alternatively that the adjustment amount be reduced to one-tenth mill where a pipeline designs its rates to that tolerance. While Tennessee makes no specific recommendation, it does claim that the

[5] There is no reduction or refund obligation with respect to increased purchased gas costs relating to rate increases authorized in existing small producer contracts.

present limitation is unreasonable for large pipelines. To illustrate, it states that under the present limitation it will be required to absorb all small producer increases until it experiences an overall annual increase of approximately $1,200,000 in its purchased gas costs. In view of its many suppliers, its frequent changes in rates and changes in purchase patterns, the limitation imposed is of minor significance. In addition, any reduction in the one mill limitation would substantially increase the number of tracking filings made by a pipeline during the course of a year to the detriment of the pipeline's customers. Consequently we shall retain the one mill limitation.

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Tennessee also inquires as to a pipeline's obligation in a situation where the operator of a producing property is a small producer who has a blanket certificate, but one of the non-signatory working interest is a large producer with an interest above 12½%. The large producer in such circumstances is required to obtain certificate authorization under Section 154.91 of the Regulations and to file the small producer's contract as its own as well as its operating agreement with the small producer. If the large producer does not obtain certificate authorization, he is not authorized to make any jurisdictional sales.

In Order No. 428 we indicated that the blanket certificate of a small producer would apply to a sale by a non-signatory small producer under a large producer's rate schedule. Tennessee asserts, however, that if a pipeline pays on the basis of the large producer's billing, it should not later be subjected to claims that the non-signatory small producer who has been selling under the large producer's rate schedule is entitled to a higher rate. For this type of sale a small producer will not be permitted to collect a higher rate than the rate in effect under the large producer's rate schedule for any period prior to the

date if notifies the large producer and the pipeline purchaser of its right to make the sale under its blanket certificate and the rate applicable thereto. However, a small producer who has filed for a small producer or blanket certificate prior to the issuance of this order shall have 30 days from the date of issuance of this order within which to make the notification required herein, and if it does so, such notification shall be effective as of the effective date of its blanket certificate.

Tennessee contends that the Commission's action of providing that the blanket certificate would be effective as of May 2, 1971, if a small producer had filed an application prior to the issuance of Order No. 428 or if it files one on or before May 2, 1971, regardless of the date of Commission action, is illegal because it would result in retroactive increases for small producers. Tennessee also claims the procedure is unfair because there is no way a pipeline can track retroactively the effect of this obligation.

The purpose of our action was to assure the small producer that its effective date for exemption would not depend on the happenstance of the date of issuance of a blanket certificate. Nor is there any retroactivity involved since the filing must be made on or before the effective date. The fact that Commission action will not be taken until after the date of filing does not make the action taken illegal.

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Such action is similar to the action taken by the Commission on an increased rate filing when it permits such filing to become effective as of the date of filing. Furthermore, there is nothing in Order No. 428 to preclude a pipeline in these circumstances from tracking an increase of this nature.

El Paso has suggested an alternative procedure to the one adopted by us pursuant to which the Commission would take

action within 60 days of the submittal of a new small producer contract by a pipeline. Under this approach the Commission would approve or disapprove the rate proposed, or, alternatively, indicate the proper rate level. During the 60 day review period the small producer would have the right to initiate deliveries without refund obligation and would be free after Commission action to terminate deliveries if it so desired.

The proposal does not go far enough. We want to facilitate the entry of the small producer into the interstate market and to assure the small producer that when he enters into a new contract, the provisions of that contract will not be subject to change. This can best be accomplished within the framework of the procedure we have adopted in Order No. 428.

Nor do we adopt El Paso's request that the first blanket certificates authorized under Order No. 428 be effective as of the first day of a calendar month, in lieu of May 2, 1971, to avoid costly and burdensome procedures in segregating purchases. We are reluctant at this stage to move the effective date back to May 1 and it would be inequitable to the small producers to push it forward to June 1. Moreover, the problems alluded to by El Paso are the same as those which arise each month when a producer places a higher rate into effect, subject to refund.

New York in its application for rehearing sought a stay of Order No. 428 until 30 days after the Commission's action on rehearing based on the assumption that the Commission might rescind or substantially modify that order, but that it might not do so until after May 2, 1971, the effective date of the order. With minor modifications,

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Order No. 428 remains intact. There is thus no justification for granting a stay now.

A number of other matters have come to our attention which warrant some discussion here. Small producer certificates issued pursuant to Order No. 428 will be effective as of May 2, 1971 if an application therefor was filed on or before May 3, 1971,[6] and as of the date of filing if an application is filed subsequent to May 3, 1971. Following the filing of an application, temporary authorization is not necessary for a small producer to commence new jurisdictional sales or to collect the contract rate for existing or new sales as of May 2, 1971, or the date of filing the application, whichever is applicable. The blanket certificate, when issued, will provide all of the necessary authorization.

As provided in Order No. 428, those producers who received small producer certificates under the procedure in effect prior to the establishment of the new procedure in Order No. 428 are deemed as of May 2, 1971, without further order of the Commission, to have blanket certificate authorization under Section 157.40(c) as now constituted.

In accordance with Order No. 428, small producers under favored-nation or other indefinite pricing clauses may charge the applicable area just and reasonable ceiling. The vintage of the gas involved will determine whether a small producer is entitled to the new or old gas ceiling. Where no just and reasonable determination is available, a small producer may charge the applicable area guideline initial rate ceiling, regardless of the vintage involved.

Finally, the blanket certificate authorization is applicable to jurisdictional sales made by a small producer from gas reserves acquired prior to the issuance of Order No. 428 by the

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[6]Inasmuch as the filing deadline fell on May 2, a Sunday, it was extended to May 3 pursuant to Section 1.13 of the Commission's Rules of Practice and Procedure.

purchase of developed reserves in place from

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a large producer. The problem sought to be solved in Section 157.40(c) by the exclusion from blanket authorization of sales from certain gas reserves has no applicability to previously acquired reserves. However, for acquisitions of developed reserves in place made on or after the issuance of Order No. 428, a small producer must apply for separate certificate authorization for jurisdictional sales relating thereto regardless of whether the large producer who sold the reserves in place retained any rights or reversionary interest in the properties involved.

*The Commission finds:*

(1) The applications for rehearing set forth no further facts or principles of law which were not fully considered in Order No. 428 (36 F.R. 5598, March 25, 1971), or which, having now been considered, warrant any modification of that order, except as hereinafter provided.

(2) The correction of footnote 4 in Order No. 428 (36 F.R. 5598 at 5600, March 25, 1971) and the revision of Section 157.39 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.39) prescribed in ordering paragraphs (B) and (C), *infra,* constitute a clarification and interpretation of Order No. 428, an existing order in this proceeding which was adopted in compliance with the requirements of 5 U.S.C. 553 after notice and opportunity to submit written comments which were received and considered by the Commission. Accordingly, further compliance with the notice, public procedure and effective date requirements of 5 U.S.C. 553 is unnecessary.

(3) The correction of footnote 4 in Order No. 428 (36 F.R. 5598 at 5600, March 25, 1971) and the revision of Section

157.39 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.39) prescribed in ordering paragraphs (B) and (C), *infra*, are necessary and appropriate for carrying out the provisions of the Natural Gas Act.

(4) Since the addition of paragraph (h) to Section 157.40 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.40) prescribed in ordering paragraph (D), *infra*, is consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

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*The Commission*, acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7, 16, and 19, 52 Stat. 822, 823, 824, 825, 830 and 831; 56 Stat. 83, 84; 61 Stat. 459; 15 U.S.C. 717c, 717d, 717f, 717o, 717r, *orders*:

(A) The applications for rehearing filed with respect to Order No. 428 (36 F.R. 5598, March 25, 1971) and New York's request for a stay are denied.

(B) Federal Register Document 71-4044 published at pp. 5598-5602, Vol. 36, of the issue dated Thursday, March 25, 1971, is corrected by deleting the words "the pipeline consents to abandonment or" in lines 4-5 of footnote 4, which footnote appears on p. 5600 at the bottom of the left-hand column.

(C) Part 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising Section 157.39 to read:

§ 157.39 Applicability of §§ 157.23 through 157.30

Sections 157.23 through 157.30 shall be applicable to independent producers as defined in § 154.91 of this Chapter, but, with the exception of § 157.30,

shall not apply to those independent producers who are subject to §157.40.

(D) Part 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations is amended by adding paragraph (h) to Section 157.40, as follows:

§ 157.40 Exemption of small producers from certain filing requirements.

* * * * *

(h) *Resale authorization for large producer.*

A large producer who has filed on or after ________________, 1971, an application

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for a certificate of public convenience and necessity for the resale of natural gas purchased from a small producer authorized to sell such gas pursuant to the blanket certificate provisions in paragraph (c) above may resell such gas at any time after the filing of its certificate application pending final Commission action thereon. Any amounts collected by a large producer for resales made pursuant to this paragraph in excess of the rate finally determined to be required by the public convenience and necessity for such resales shall be subject to refund with interest at 7 percent per annum.

(E) This order shall be effective upon issuance.

(F) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Secretary

SUPREME COURT OF THE UNITED STATES

No. 72-1490

FEDERAL POWER COMMISSION, PETITIONER

*v.*

TEXACO, INC. et al.

ORDER ALLOWING CERTIORARI—Filed October 9, 1973

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted. The case is consolidated with No. 72-1491 and a total of one hour is allotted for oral argument.

Mr. Justice Stewart took no part in the consideration or decision of this petition.

SUPREME COURT OF THE UNITED STATES

No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS, ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., PETITIONERS,

*v.*

TEXACO, INC., et al.

ORDER ALLOWING CERTIORARI—Filed October 9, 1973

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted. The case is consolidated with No. 72-1490 and a total of one hour is allotted for oral argument.

Mr. Justice Stewart took no part in the consideration or decision of this petition.

# INDEX



CITATIONS

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501-092—73——1

# In the Supreme Court of the United States

OCTOBER TERM, 1972

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No.

FEDERAL POWER COMMISSION, PETITIONER

*v.*

TEXACO INC., ET AL.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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The Solicitor General, on behalf of the Federal Power Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra,* pp. 1a–22a) is not yet reported. The initial order (No. 428) of the Federal Power Commissioon (App. D, *infra,* pp. 29a–46a), its order (No. 428–A) of amendment (App. E, *infra,* pp. 47a–49a), and its order (No. 428–B) denying rehearing (App. F, *infra,* pp. 50a–84a) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

## JURISDICTION

The judgment of the court of appeals was entered on December 12, 1972 (App. B, *infra*, pp. 23a–25a) and the Commission's petition for rehearing was denied on February 5, 1973 (App. C, *infra*, pp. 26a–28a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTION PRESENTED

Whether the Federal Power Commission has authority to exempt small producers from certain filing requirements under the Natural Gas Act, 15 U.S.C. 717, *et seq.*, and to regulate the interstate wholesale sales of such small producers indirectly through review in pipeline rate proceedings of the costs to interstate pipelines of purchasing gas from small producers.

## STATUTES INVOLVED

Sections 4, 5, 7, and 16 of the Natural Gas Act, 15 U.S.C. 717c, 717d, 717f, and 717*o*, are set forth in Appendix G, *infra*, pp. 85a–93a.

## STATEMENT

### A. BACKGROUND

In 1954, this Court held in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, that the Federal Power Commission has jurisdiction under the Natural Gas Act, 15 U.S.C. 717, *et seq.*, to regulate well-head sales by producers of natural gas to interstate pipelines. Producers were thus required under Section 7(c) of the Act, 15 U.S.C. 717f(c), to obtain certificates of

public convenience and necessity to cover their sales to interstate pipelines; all contracts covering such sales were required to be filed with the Commission under Section 4(d) of the Act, 15 U.S.C. 717c(d), and all rates and charges were required under Section 4(a), 15 U.S.C. 717c(a), to be "just and reasonable." Under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d, the Commission is empowered to inquire into the lawfulness of any rate and, in the event it finds a rate unlawful, to determine and prescribe the just and reasonable rate.

Following the *Phillips* decision, the Commission at first attempted to regulate producer sales on a traditional, individual basis. After this method of regulation proved thoroughly impractical, the Commission in 1960 instituted area rate proceedings to determine maximum producer rates for each of the major producing areas. See *Permian Basin Area Rate Cases,* 390 U.S. 747, 755–758. The area rate proceedings themselves have proved to be enormously complex, and the Commission has accordingly found its ability to meet its obligations under the Act to regulate producer sales to be critically dependent upon its authority under Section 16, 15 U.S.C. 717*o*, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

Indeed, this Court has encouraged the Commission to make liberal use of this statutory authority to treat different classes of producers differently. The suggestion that small producers be exempted from cer-

tain provisions of the Act was first made by Mr. Justice Clark in dissent (*Wisconsin* v. *Federal Power Commission,* 373 U.S. 294, 329–330) and was later reiterated by him speaking for a majority of the Court (*Federal Power Commission* v. *Hunt,* 376 U.S. 515, 527). The Commission followed these suggestions in its first area rate proceeding and exempted small producers from various filing requirements under Sections 4 and 7 of the Act. 34 FPC 234, 235. On review, this Court sustained the Commission's separate treatment of small producers; it held (*Permian Basin Area Rate Cases, supra,* 390 U.S. at 787):

> We conclude that these arrangements did not exceed the Commission's statutory authority. We recognize that the language of §§ 5 and 7 is without exception or qualification, but it must also be noted that the Commission is empowered, for purposes of its rules and regulations, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." § 16, 15 U.S.C. § 717*o*. The problems and public functions of the small producers differ sufficiently to permit their separate classification, and *the exemptions created by the Commission for them are fully consistent with the terms and purposes of its statutory responsibilities.* It is not without relevance that this Court has previously expressed the belief that similar arrangements would ameliorate the Commission's administrative difficulties. See *F.P.C.* v. *Hunt,* 376 U.S. 515, 527. [Emphasis supplied.]

In recent years, the Commission's difficulties in regulating producer sales have been compounded by the increasingly critical shortage of natural gas supplies. This shortage, which has been judicially recognized by this Court and the courts of appeals,[1] has seriously affected the ability of the Nation's major pipelines to meet the demands of their interstate markets. At the current time, some 26 curtailment proceedings—of the type before this Court last Term in *Federal Power Commission* v. *Lousiana Power & Light Co.*, 406 U.S. 621—have been initiated before the Commission. It is in this context that the Commission's special treatment of small producers in the instant controversy should be viewed.

B. PROCEEDINGS BEFORE THE COMMISSION

In July 1970, the Commission initiated the present proceedings by issuing a notice of proposed rule-making proposing to exempt from regulation under the Natural Gas Act all existing and future jurisdictional sales made by small producers[2] (35 Fed. Reg. 12220). Following the receipt of comments from numerous parties, the Commission issued Order No. 428 (App. D, *infra*, pp. 29a–46a). In that order, the Commission did not exempt small producer sales from all

[1] See, *e.g.*, *Federal Power Commission* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 626; *Placid Oil Co.* v. *Federal Power Commission*, C.A. 5, No. 71–2761, decided April 16, 1973, slip op. at 23–30; *Public Service Commission for the State of New York* v. *Federal Power Commission*, 467 F.2d 361 (C.A.D.C.).

[2] Small producers are defined as those with jurisdictional sales of less than 10,000,000 Mcf of gas per year.

regulation, but rather adopted a form of regulation which it deemed appropriate in the circumstances.

The purpose and intended effect of the Commission's action were stated in Order No. 428 as follows (App. D, *infra*, pp. 31a–32a):

> One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By our action herein, we are taking an important step forward to meet this responsibility. Upon review of the contentions made by the various parties, we have decided that both existing and future sales of small producers shall be regulated in the manner hereinafter provided.
>
> Such action should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas. Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the administrative burdens connected with processing small producer filings.[3]

[3] While the Commission stressed the importance of small producer exploratory efforts, it also noted that actual small producer sales amounted to an average of only 10.52 percent of the needs of interstate pipelines (*id.* at 32a).

The action taken by the Commission was to establish a procedure whereby each small producer could obtain a blanket certificate to cover all existing and future sales. Once the blanket certificate was obtained, the small producer would be authorized to sell natural gas at negotiated contract prices whether or not such prices are in excess of the area rates established by the Commission;[4] the small producers were relieved of all filing requirements under the Natural Gas Act or the Commission's regulations other than the requirement to file annual reports (*id.* at 38a–39a).

The Commission expressly stated that its action does not constitute "deregulation" of small producer sales (*id.* at 32a). Such sales would be regulated indirectly through review of purchased gas costs in pipeline rate proceedings (*ibid.*). Pipeline rates would be subject to reduction and refund to the extent that they were based upon small producer rates which were found to be unreasonably high when compared to the "highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area" (*id.* at 37a). In order to assure the certainty of the capital flow necessary to encourage exploration and development by small producers, however, the Commission exempted small producers from any refund obligations (*id.* at 37a–38a).

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[4] In Order No. 428-B, modifying Order No. 428 and denying applications for rehearing, the Commission ruled that sales made by small producers under blanket certificates could not be abandoned without Commission authorization pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b) (App. F, *infra*, pp. 54a–55a).

Finally, the Commission expressed its intention

> * * * to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers. [App. D, *infra*, p. 40a.]

In April 1971, the Commission issued Order No. 428–A (App. E, *infra*, pp. 47a–49a) prescribing the form of the annual statement to be filled by small producers operating pursuant to blanket certificates. In July 1971, the Commission issued Order No. 428-B (App. F, *infra*, pp. 50a–84a) modifying Order No. 428 in certain respects and denying applications for rehearing.

C. THE DECISION BELOW

On petitions for review, the court of appeals, with one judge dissenting, set aside the Commission's orders establishing a blanket certificate procedure for small producers (App. A, *infra*, pp. 1a–22a). The court concluded that, by authorizing blanket certificates for small producer sales, the Commission had abdicated its statutory responsibilities under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d, to insure that small producer rates will be "just and reasonable' (*id.* at 10a-16a). The court rejected the Commission's contention that small producer sales could appropriately be regulated indirectly through the review of purchased gas

costs in pipeline rate proceedings. The court held that the Commission could not review small producer rates indirectly on the basis of "factors which it does not regulate or which derive solely from market forces" (*id.* at 12a).

Judge Fahy dissented. Citing this Court's recent decision in *Federal Power* v. *Louisiana Power & Light Co.*, 406 U.S. 621, he concluded (*id*, at 19a–20a):

> The Commission has made a judgment which I think is within the ambit of its competence and expertise not to require small producers to be bound to the area rate and certain filing requirements, on an experimental basis. * * * The Commission is attempting to learn whether under this program the small producers, relieved of much of the burden of regulation required of other classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable, and which will not adversely affect the consumer interests protected by the Act. [Footnotes omitted.]

## REASONS FOR GRANTING THE WRIT

This case presents a significant question concerning the Commission's authority under the Natural Gas Act, 15 U.S.C. 717, *et seq.*, to make pragmatic adjustments in its regulatory procedures in order, consistently with its regulatory obligations, to help alleviate the shortage of natural gas which now concerns the nation. Small producers, although accounting for a relatively small percentage of natural gas sales to

interstate pipelines, have historically undertaken the bulk of all explorations for new natural gas supplies. The continuation and expansion of their exploratory activities are of major importance to the provision of adequate supplies of natural gas in the years ahead. It was in order to provide the necessary capital and incentive to stimulate the exploration efforts of small producers that the Commission promulgated the orders here under review.

In holding that the Commission may not issue blanket certificates to small producers and regulate small producer sales indirectly through the review of purchased gas costs in pipeline rate proceedings, the court of appeals deprived the Commission of an important tool for protecting the consuming public against continued and increasing natural gas shortages;[5] the court also departed from the rationale of earlier decisions of this Court authorizing special treatment for small producers and establishing the appropriate criteria for determining whether producer rates are just and reasonable under the Act.

1. As we have noted, the Commission's authority to treat the class of small producers differently from other producers stems from Section 16 of the Act, 15 U.S.C. 717*o*, which provides in pertinent part:

> The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regu-

[5] Judge Fahy noted in dissent that "consumer protection is promised" by the Commission's orders (App. A, *infra*, p. 21a).

> lations as it may find necessary or appropriate to carry out the provisions of this act. * * * For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. * * *

The importance of Section 16 to the Commission's administration of the Natural Gas Act has been recognized by this Court. In *Federal Power Commission* v. *Louisiana Power & Light Co., supra*, 406 U.S. at 642, the Court noted:

> FPC and other agencies created to protect the public interest must be free, "within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances." *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942). Section 16 of the Act assures the FPC the necessary degree of flexibility * * *.

And in the *Permian Basin Area Rate Cases, supra*, the Court relied squarely on Section 16 in sustaining the Commission's special treatment of small producers (see p. 4, *supra*).

Contrary to the opinion of the court of appeals, the Commission has not attempted in this case, under the authority of Section 16, to exempt small producer sales from the substantive requirements of the Natural Gas Act. As we have pointed out (pp. 7–8, *supra*), the Commission repeatedly stated in Order No. 428 that it was not deregulating small producer sales, but was

adopting a mode of regulation which would stimulate exploration to help alleviate the natural gas shortage. Insofar as the substantive standards of the Act are concerned, all rates for jurisdictional sales by small producers must continue to be "just and reasonable" in compliance with Section 4(a) of the Act. And small producer rates remain subject to investigation and prospective reduction in Section 5 proceedings. In stating its desire to assure the small producer that the provisions of the new contracts "will not be subject to change" (App. D, *infra*, p. 31a), the Commission did not foreclose prospective rate modification under Section 5 where necessary to insure compliance with the "just and reasonable" standard. On this point, the Commission explicitly stated that it would "review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged" and that it would "take further action to protect the consumers" in the event that "this approach is inimical to the interests of consumers" (*id.* at 40ea).

2. The holding of the court below that the Commission may not rely upon market factors in reviewing the lawfulness of small producer rates in the context of pipeline rate proceedings (see App. A, *infra*, pp. 11a–14a), is contrary to this Court's opinion in *Permian Basin Area Rate Cases, supra.* In *Permian*, the Court found that the record supported the Commission's determination that at that particular time contract or field prices negotiated on the open market could not be relied upon to produce just and reasonable rates. The Court refused, however, to fore-

close reliance on market factors in the future and specifically stated (390 U.S. at 795):

> We do not now hold, and the Commission has not suggested, that field prices are without relevance to the Commission's calculation of just and reasonable rates under § 5(a). *The records in subsequent area rate proceedings may more clearly establish that the market mechanism will adequately protect consumer interests.* We hold only that, on this record the Commission was not compelled to adopt field prices as the basis of its computations of area rates. [Emphasis supplied.]

Since the Commission's decision in *Permian* in 1965 (34 FPC 159), this country has experienced a critical shortage of gas supply. Under present conditions, the Commission determined that reliance on the market mechanism would encourage the highly competitive small producers to explore for new supplies of natural gas and would result in just and reasonable rates in the best interests of consumers. This determination should have been upheld by the court of appeals.[*]

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[*] The approach of the court below in striking down Order No. 428 is in marked contrast to the approach of the Fifth Circuit in *Placid Oil Co.* v. *Federal Power Commission*, *supra*, in upholding the Commission's order establishing just and reasonable rates in Southern Louisiana. In a footnote to its opinion, the Fifth Circuit referred to the Commission's small producer order in this case and stated (slip op. 68, n. 40): "We are very impressed by the pragmatic and flexible manner in which FPC has approached natural gas rate regulation as a whole." Earlier in its opinion the court noted (slip op. 34–35, n. 19): "Final administrative determination of 'just and reasonable' rates may get closer and closer to a basis of existing market conditions."

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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*Solicitor General.*

SAMUEL HUNTINGTON,
*Assistant to the Solicitor General.*

LEO E. FORQUER,
*General Counsel,*

GEORGE W. MCHENRY, JR.,
*Acting Solicitor,*
*Federal Power Commission.*

MAY 1973.

# APPENDIX A

## United States Court of Appeals for the District of Columbia Circuit

No. 71-1560

TEXACO, INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
MRS. JAMES R. DOUGHERTY, ET AL, INTERVENORS

No. 71-1561

CONSOLIDATED GAS SUPPLY CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
MRS. JAMES R. DOUGHERTY, ET AL, INTERVENORS

No. 71-1603

JAMES M. FORGOTSON, SR., AN INDEPENDENT NATURAL GAS PRODUCER, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
MRS. JAMES R. DOUGHERTY, ET AL
TEXACO, INC., INTERVENORS



501-092—73——2

No. 71–1612

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
TEXACO, INC., INTERVENOR

No. 71–1627

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

No. 71–1647

WARREN PETROLEUM CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

No. 71–1722

TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

No. 71–1727

PHILLIPS PETROLEUM COMPANY, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
TEXACO, INC., INTERVENOR

No. 71–1729

TEXACO, INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

*Petition for Review of an Order of the Federal Power Commission*

Decided December 12, 1972

*Mr. Richard A. Solomon,* with whom *Messrs. Peter H. Schiff* and *Saul W. Baernstein* were on the brief, for petitioner in No. 71–1612.

*Mr. Christopher T. Boland,* with whom *Messrs. Robert G. Hardy* and *Jerome J. McGrath* were on the brief, for petitioner in No. 71–1627, also argued for petitioners in No. 71–1561 and 71–1722.

*Mr. John T. Ketcham,* with whom *Messrs. Kenneth Heady, Warren M. Sparks, Charles E. McGee* and *Robert J. Haggerty* were on the brief, for petitioner in No. 71–1647 and 71–1727 also argued for petitioners in Nos. 71–1560 and 71–1729.

*Mr. Michael J. Manning,* Attorney, Federal Power Commission for respondent. *Messrs. Gordon Gooch,* General Counsel, Federal Power Commission, *Leo E. Forquer,* Solicitor and *George W. McHenry, Jr.,* First Assistant Solicitor, Federal Power Commission were on the brief, for respondent. *Mr. J. Richard Tiano,* First Assistant Solicitor, Federal Power Commission at the time the record was filed, also entered an appearance for respondent.

*Mr. Benjamin F. Vaughan, III,* with whom *Mr. R. James George, Jr.,* was on the brief, for intervenors Mrs. James R. Dougherty, et al.

*Messrs. J. Donald Annett* and *Kirk W. Weinert* were on the brief for petitioners in No. 71–1560 and No. 71–1729 and Intervenor, Texaco, Inc.

*Messrs. Norman A. Flannigan, Charles R. Brown,* and *Richard J. Connor,* were on the brief, for petitioners in No. 71–1561.

*Mr. Edward H. Forgotson,* was on the brief, for petitioners in No. 71–1603.

*Messrs. Melvin Richter, Dale A. Wright* and *Harry S. Welch* were on the brief, for petitioner in No. 71–1722.

*Messrs. L. Dan Jones* and *William I. Powell* filed a brief on behalf of the Independent Petroleum Association of America, as *amicus curiae* urging affirmance.

*Messrs. Philip R. Ehrenkranz* and *Clyde O. Martz* filed a brief on behalf of Anderson Oil Company, et al and Hickerson Oil Company, et al as *amici curiae* urging affirmance.

Before FAHY, *Senior Circuit Judge,* ROBINSON and WILKEY, *Circuit Judges.*

Opinion by Circuit Judge Wilkey.

Dissenting opinion by Senior Circuit Judge Fahy at p. 18.

WILKEY, *Circuit Judge:* Petitioners seek review of orders of the Federal Power Commission [1] in Docket No. R–393, a rulemaking proceeding instituted by a Notice [2] entitled "Exemption of Small Producers

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[1] The Commission's original Order No. 428 was issued on 18 March 1971. It was subsequently modified by Order No. 428–A, issued 9 April 1971, and Order No. 428–B, issued 15 July 1971.

[2] Issued 23 July 1970. It should be noted that some of the petitioners challenge the sufficiency of that notice. Since all important objections were raised and considered prior to the action of the Commission in Order No. 428–B, we do not agree that further publication is required by the Administrative Procedure Act. In any event, given our disposition of these cases, that issue need not be reached.

From Regulation."[3] These orders exempted all existing and future sales by "small producers"[4] from direct rate regulation. Small producers could, thereunder, contract for the sale of their gas at any obtainable rates. The Commission proposed indirectly to control such rates by regulating, under standards set forth in the orders, the costs allowed to be incorporated in the rates of large producers and pipelines on resale of gas which originated with small producers. Even if resale rates were found excessive because the cost of small producer gas was "unreasonably high," small producers would be under no duty to refund the absorbed excess to the large producers and pipelines. Since we conclude that the Commission exceeded its authority under the Natural Gas Act, the orders in Docket No. R-393 must be set aside.

## I. THE ENDS

Our conclusion herein challenges neither the Commission's motives nor its opinion that some form of deregulation of small producers might benefit the consumers of natural gas. The orders represent an imaginative attempt to deal with problems of enormous magnitude. A critical gas shortage, which has been

[3] Joint Appendix (hereafter "J.A.") at 1. The resulting Order 428 was entitled "Order Establishing Blanket Certificate Procedure For Small Producer Sales and Providing Relief From Detailed Filing Requirements." As this opinion will explain, the actual terms of this order belie its title's suggestion that its effect is more limited than that implied by the broad title of the Notice of Proposed Rulemaking.

[4] Small producers are defined as those with jurisdictional sales of less than 10,000,000 Mcf of gas per year. Such producers would be required to submit annually a document setting forth pertinent information concerning their jurisdictional sales.

judicially recognized,[5] faces the nation. The Federal Power Commission is confronted with an ever-increasing regulatory burden—and limited resources. These combine to produce administrative delay and threaten the Commission's ability adequately to control natural gas prices.

Since small gas producers have historically accounted for as much as 80% of new exploration, but have less ready access to the necessary capital than do large producers, after thorough study the Commission concluded that generally beneficial exploration activity would be encouraged by assuring stable revenue flows to small producers. From deregulation of small producers, realization of their full contract prices at market levels would become a certainty. Since the small producers only account for 10.5% of the gas put into pipelines, the FPC felt that any cost hike resulting from deregulation would have a minimal effect on consumers. Obviously, any step towards deregulation would lessen the Commission's administrative load.

This court also recognizes that the Commission was engaged in good faith, in what it felt was a valid extrapolation from judicial comments as to which solutions to these problems would be acceptable. In *FPC* v. *Hunt,* Justice Clark made the following suggestion for dealing with the Commission's docket congestion:

> [T]he techniques of the National Labor Relations Board might be studied with a view to determining whether its exemption practices ... might be helpful in the solution of the Commissions problems.[6]

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[5] See *Southern Louisiana Area Rate Cases* v. *FPC*, 428 F. 2d 407, 437 (5th Cir. 1970), *cert. denied*. 400 U.S. 950.

[6] 376 U.S. 515, 527 (1964).

In more recent cases, this court has explicitly encouraged experimentation to meet the threat of a gas shortage.[7] Given traditional judicial deference to the agency's expertise, the FPC obviously concluded that it would be allowed to embark upon, and later evaluate, an experimental approach to achieving the purposes of the Natural Gas Act.

## II. THE MEANS

However, Congress has prescribed limits on the Commission's authority. The orders considered here can be upheld only if they comply with the specific provisions of the Natural Gas Act. The Commission may, of course, classify different types of producers, alter some filing requirements, and "make other pragmatic adjustments which may be called for by particular circumstances."[8] However, the FPC must act "within the ambit of [its] . . . statutory authority."[9] The Commission may not ignore the command of Section 4 (15 U.S.C. § 717(c)(a)):

> *All* rates and charges made, demanded, or received by *any* natural-gas company for or in connection with the . . . sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and *any* such rate or charge that is not just and reason-

[7] *Public Service Commission* v. *FPC*, —— U.S.App.D.C. ——, —— F.2d —— (No. 71-1161, decided 29 March 1972, slip op. at 12) (*rehearing denied* 19 May 1972); *Public Service Commission* v. *FPC*, —— U.S.App.D.C. ——, —— F.2d —— (Nos. 71-1197, *et al.*, decided 16 May 1972), slip op. at 9.

[8] *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

[9] *FPC* v. *Natural Gas Pipeline Co.*, *supra*.

> able is hereby declared to be unlawful. [Emphasis added.][10]

The Commission must also heed similar language in Section 5 (15 U.S.C. § 717(d)):

> Whenever the Commission, after a hearing had upon . . . complaint of any State, municipality, State Commission, or gas distributing company, shall find that *any* rate, charge or classification demanded, observed, charged, or collected by *any* natural-gas company in connection with *any* . . . sale of natural gas, subject to the jurisdiction of the commission . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission *shall* determine the just and reasonable rate, charge, classification . . . or contract to be thereafter observed and in force, and *shall* fix the same by order . . . [Emphasis added.]

Ever since *Phillips Petroleum Co.* v. *Wisconsin,* the Commission, even against its own will, has had a judicially recognized duty to assume "jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce"[11] to insure that all such rates comply with the statutory standard.

### A

We cannot accept the Commission's argument that it may shirk this duty. To the extent that the Commission argues that Justice Clark's dicta in *Hunt*

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[10] The Supreme Court has described "the fixing of 'just and reasonable' rates" as "the heart of the new regulatory system." *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944).

[11] 347 U.S. 672, 682 (1954). (Emphasis added.) It should be noted that Justice Clark, in dissent, conceded that "[o]n its face, this language brings every gas operator, *from the smallest producer to the largest pipeline*, under federal regulatory control." 347 U.S. 672, 691 (emphasis added).

imply that exemption of a class of producers from the statutory standard would be permissible, we note that reliance cannot be placed on the NLRB as a model. The National Labor Relations Act specifically permits the Labor Board to decline to exercise its own jurisdiction.[12] In contrast, as evidenced by *Phillips,* the Natural Gas Act does not give the Commission any such power. Only this year the Supreme Court specifically contrasted the FPC and the NLRB, suggesting that the former's jurisdiction will be broadly construed so that there are no "gaps" in the Natural Gas Act's "comprehensive and effective regulatory scheme."[13] Further, the trials and experimentations which this court has previously approved have always been trials of new procedures consistent with the terms of the Natural Gas Act, not experimental attempts to amend, avoid or ignore these provisions.[14]

The Commission relies heavily on *Permian Basin Area Rate Cases*[15] to support the proposition that it may exempt small producers from certain requirements. However, the "exemptions" approved there were from detailed filing requirements, not from all regulation. The Court in *Permian* specifically noted that "the exemptions created by the Commission" were "fully consistent with the *terms* and purposes of its statutory responsibilities."[16]

Thus the Commission's power, under Section 16 of the Natural Gas Act, to "classify persons and matters

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[12] 29 U.S.C. 160(a).

[13] *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 631 (1972).

[14] Deregulation is decidedly not one of the "policy decisions of the type [the FPC] . . . was created to make." See *Public Service Commission* v. *FPC* (No. 71-1161), *supra.*

[15] 390 U.S. 747 (1968).

[16] *Id.* at 787. (Emphasis added.)

within its jurisdiction" and to "prescribe different requirements for different classes" cannot validate this exemption of small producers. The Commission can only classify "[f]or the purposes of its rules and regulations." It can only prescribe rules and regulations "to carry out the provisions of this chapter." Section 16 thus does not give the Commission independent powers. Rather, it provides for implementation of the core sections of the Act, such as Section 4.

### B

Nor can we accept the Commission's argument that it has met its obligation to insure the statutory standard of "just and reasonable" rates by indirectly controlling small producer prices through regulation of large producers and pipelines. That argument might have some merit if the Commission had provided that small producer rates could only be passed along on resale as legitimate costs if they met the "just and reasonable" standard.[17] In essence, that is what the

[17] However, in that event, we might have greater problems with the validity of subjecting the pipelines and large producers, who have made *unrefundable* payments to small producers, to the risk of *later* Commission determination, under such an imprecise standard, that the rates paid could not be passed along as legitimate costs. The Commission itself, in Order No. 428–B, recognized that it would be desirable for "the pipelines to know in advance the boundaries within which they could freely contract with small producers." J.A. at 246. Unfortunately, in the case at bar, the Commission chose a "more concrete guide" with no relation to the mandatory statutory standard.

Judge Fahy has suggested modification of the Order to strike its provisions prohibiting refunds from small producers and to leave open the Commission's authority to protect large producers and pipelines from unreasonably high small producer prices. That approach would only compound the un-

Commission was allowed to do in *Permian*. There, specific and direct regulation of small producer rates was held unnecessary because all such rates were required to be below the area ceiling rate—a rate level already determined by the Commission to be "just and reasonable."[18]

Here, however, the Commission set forth a different sort of guideline for its indirect regulation. The novel tests proposed are nowhere spelled out in the Act or in any decision applying the Act. Small producer rates can only be passed along to consumers if they are not

> unreasonably high, considering appropriate comparisons with *highest contract prices* for sales by large producers *or* the prevailing market, price for *intrastate* sales in the same producing areas.[19]

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certainty and risk for all concerned. Moreover, it would defeat the basic purpose of the Order—encouraging exploration by assuring small producers of a steady flow of funds under their contract rates.

[18] When the Commission says on pages 16 and 17 in its brief that the only difference in its new scheme from that which the Supreme Court approved in *Permiam* in 1968 is that now the small producers are allowed to exceed the area rate ceiling determined to be just and reasonable, then of course the Commission is saying that the whole issue in the lawsuit is no different from *Periam*. That just isn't so. The absence of such a "just and reasonable" limit *is* the big difference. Order No. 428 not only allows small producers to exceed the reasonable and just area rate ceilings—it allows them to do so on the basis of the free market, which is the antithesis of regulation.

[19] J.A. at 142. These standards apply to both pipelines and large producers. In addition, large producers may reflect their increased payments in rate increases only if the contract price differential between their purchase and resale prices is "consistent with prevailing price differentials in the area." J.A. at 140.

Whether or not these two factors would establish precise boundaries on acceptable rates, the Commission has clearly tied its determination to factors which it does not regulate or which derive solely from market forces.[20] Large producers can, of course, *contract* for *any* prices, presumably in the hope that such payments must eventually be allowed under the regulatory scheme as legitimate costs actually incurred. *Intrastate* sale prices are at no point subject to regulation by the Commission.

The Commission has a duty to insure that all rates are "just and reasonable." [21] At best, the indirect controls it has proposed will insure that the small producer rates which are passed on to consumers are below levels set by private contracting parties (or potentially by state regulation which is not necessarily tied to the federal standard). Nothing at all insures that those levels will be "just" or "reasonable." That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory

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[20] In the different context of individual ratemaking proceedings, this court has insisted that the Commission's determinations be "anchored" to factors with some meaningful relationship to what is "just and reasonable." See *City of Chicago* v. *FPC*, —— U.S. App. D.C. ——, 458 F. 2d 731, 750 (1971), *cert. denied*, 405 U.S. 1074 (17 April 1972); and *City of Detroit* v. *FPC*, 97 U.S. App. D.C. 260, 230 F. 2d 810 (1955), *cert. denied*, 352 U.S. 829 (1956). As the court noted in *City of Detroit*, a new Commission approach to regulation is not invalid merely because it departs from the traditional rate-base or cost-of-service methods. However, even granting the legitimacy of indirectly regulating small producer rates, the standards set forth in Order No. 428 have not been demonstrated to have any relationship at all to the statutory standard.

[21] To the extent that new sales are covered by the blanket small producer certificates, the Commission has also abandoned any attempt to scrutinize the rates involved in such sales against Section 7's standard of "public convenience and

responsibility in derogation of the purposes and mandatory terms of the statute. Indirect "regulation" by such novel "standards" is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing.

One variant of the "indirect regulation" argument might contend that, while the *Commission* would no longer be regulating rates, the *market mechanism* itself would, in effect, dictate small producer prices which were "just and reasonable." However, though

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necessity." Were that the only effect of Order 428, we might have a different case. If there remained a potential for future review under the standards of Sections 4 and 5, the "public convenience and necessity" might indeed be served by temporarily allowing certification of rates meeting the novel standards proposed by the FPC. Indeed, rates are "not . . . the only factor bearing on the public convenience and necessity." *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 391 (1959). Unlike the situation in *Atlantic Refining*, small producer rates would probably not set a pattern for the whole industry. However, the Commission here abandoned *any* future rate review under the "just and reasonable" standard. In its more recent rulemaking Orders Nos. 455 and 455–A, the Commission seems to have admitted that it has no such power. Those Orders, consolidating the Section 4 and Section 7 tests in an optional certificate procedure for new gas sales, also sought to assure producers of certain receipt of their certified contract rates. In that context, the Commission conceded that "[w]e cannot bind a future Commission not to invoke the prospective operation of Section 5, nor do we attempt to do so." Mimeo, pp. 9–10. In marked contrast is the Commission's statement regarding Order No. 428: "We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change." We conclude that Order No. 455 contains the more correct view of the statutory limits on the Commission's power.

ingenious on a semantic level, that argument ignores the essential difference between a regulated and an unregulated industry. Put simply, the latter is governed by the market while the former, by definition, is the subject of active governmental control.

More importantly, such a post hoc rationalization does not coincide with the Commission's own view of its Order. The FPC flatly concedes that "[t]he Commission's order does not purport to determine the just and reasonable rates for sales by small producers."[22] To the contrary, the Commission's basic contention all along has been that the "just and reasonable" standard was not mandatory and that the FPC can simply choose not to regulate rates.[23] It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these "just and reasonable" rates without further review under new non-statutory standards. Since the Commission itself has not been confident enough to conclude that the market will necessarily yield rates that comply with the statute, this court can hardly uphold the Orders on that ground.

Our dissenting colleague believes that "[t]he Commission has made a judgment which I think is within the ambit of its competence and expertise not to require small producers to be bound to the area rate ..., on an experimental basis." (P. 20) But the "area rates" are the previously Commission-determined "just and reasonable" rates, from which, no matter how one phrases it, the small producers will be exempt, even though on an experimental basis. It is significant that the Notice for this rulemaking pro-

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[22] Commission's Brief at p. 35.

[23] Joint Appendix at p. 136.

ceeding was frankly titled "*Exemption* of Small Producers from Regulation." Our dissenting colleague correctly notes that the Order which issued carried the title "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements." This rose by another name carries the same thorns.

Judge Fahy notes that the Commission intends to review the results of its experiment. Presumably, if that review showed unjust and unreasonable rates developing, the Commission would consider reinstating the regulatory scheme. However, even if it did so, the rates charged during the interim period would not have been subject to regulation. It seems most unlikely that any "further action to protect consumers" could legally reimburse those who made payments, valid under the Commission's own rules during that experimental period, were we to approve those rules here.

The Commission further defended its decision on the grounds that, given their limited percentage of the market, a rise in small producer prices will have no great effect on consumers.[24] We doubt that the effect of potentially allowing greater than area ceiling rates for 10.5% of the gas sold can be considered *de minimis*. In any case, the long-range impact of these orders on consumers lies more in the principle they establish than in any immediate effect on prices. We think it undeniable that the Commission could, under its theory of this case, proceed to establish another class of "medium" producers, and provide the same or different appropriate exemptions for this new class, and Commission counsel so conceded in oral argu-

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[24] A *de minimis* effect on consumer prices seemed to weigh with the Court in *Permian* with regard to one of the approved "exceptions." 390 U.S. 747, 786–87, n. 56, and accompanying text (1968).

ment. Likewise, the Commission could, again by its own fiat, change the definition of small producer to include those with greater volumes of jurisdictional sales.

If Order No. 428 is upheld, no limit appears which could halt gradual erosion of the statutory standard's applicability. Given the Commission's self-professed distaste for regulation, a decision upholding its approach here might soon yield further FPC decisions which made the instances where rates were determined by the "just and reasonable" standard the exception rather than the rule.

Whatever the wisdom of the policy at this critical juncture of our national energy source problems, we cannot hold that *non*regulation is the statutory equivalent of regulation. Only Congress can knowingly prescribe nonregulation for small producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* to be mandatory under the Natural Gas Act for all producers.

### III. MEANS TO THE DESIRED END

All of this is not to say that a proper regulatory determination, within the letter and spirit of the Natural Gas Act, could not set a just and reasonable rate for small producers higher than that for large producers. Given the special problems and practices of small producers, such a result is certainly conceivable. But the small producers cannot be exempted from the regulatory scheme, and have their prices tied to the free market, by administrative agency fiat.

Nor is the scheme saved by the laudable purpose of the Commission, described by our dissenting colleague: "The Commission is attempting to learn whether under this program the small producers, re-

lieved of much of the burden of regulation required of other classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable and which will not adversely affect the consumer interests protected by the Act." (P. 20) With all due respect to Judge Fahy and the Commission, what it is doing is experimenting to see if, after all, *non*-regulation of the small producers, letting market forces shape the price structure, will not in the long run be better both for industry and consumer. Whether this be so or not, the place for authorizing such experiments outside the present language of the Act is in Congress.[23] And, as noted immediately above in Part II, the means adopted by the Commission here are capable of being employed to the complete subversion of the regulatory scheme.

The Power Commission has made a conscientious and intelligent effort to cope with an enormous national problem. Where the Commission has failed is not in its diligence and its expertise. It has simply failed because the methods adopted do not square with its duties under the Natural Gas Act. This court's

[23] The Congress could itself classify small producers, exempt them from regulation for a designated period of time, and meanwhile order the Commission to gather empirical data to see if this is beneficial to the industry and to consumers of natural gas. While we do not reach the details of the Commission's plan here, we should note that the different parties pointed out various inequities, each from its own point of view. The Commission might be well advised to make certain refinements in its overall plan before recommending it to Congress. In particular, the standards to be applied to resale by non-exempt producers and pipelines would benefit from greater precision—so that these businesses could know in advance what their position would ultimately be and would not have to rely on the good will of the Commission for their economic salvation.

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role, in regard to the actions of regulatory commissions, is to insure that such bodies comply with applicable legislation. The Commission's imagination and ingenuity here simply outran the statute. The place to bring these resources to bear is in Congress. If exemption is advisable, and the Commission appears to have made a powerful case that it is, Congress should have a receptive ear. In the interim, this court cannot ignore the statute or excuse the Commision from its duty.

Accordingly, the orders of the Commission in Docket No. R-393 are set aside.

*So Ordered.*

FAHY, *Senior Circuit Judge, dissenting:* I agree with the court that all rates and charges of any natural-gas company subject to the jurisdiction of the Natural Gas Act, which includes the small producers here involved, shall be just and reasonable and, if not, that they are unlawful. But we have no particular rate or charge before us for scrutiny as to its justness or reasonableness. Order No. 428 of the Commission, before us for review, was made in a rulemaking proceeding duly conducted. It passed upon no particular rate or charge of any or all small producers. It laid down certain guides within which small producers may contract for sales of their gas. It is properly entitled by the Commission as an "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements." The Commission explicitly relies upon the Supreme Court decision in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968), to the effect that under section 16 of the Act,[1] for purposes of its rules and regulations, the Commission may "classify persons

[1] 15 U.S.C. § 717(o) (1970).

and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." It cannot be questioned that it is within the power of the Commission separately to classify small producers.[2] The question really is whether the rules or regulations applied to this classified group are within the Act. More precisely, as it seems to me, the question is whether we can hold, on the record before us, that the type of regulation of prices adopted by the Commission has led or will lead inevitably to unjust or unreasonable rates charged by small producers to purchasers of gas from them, notwithstanding

> [a] presumption of validity . . . attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequencies". . . .
>
> . . . [I]t must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests.

*Permian, supra,* 390 U.S. at 767.

The Commission has made a judgment which I think is within the ambit of its competence and ex-

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[2] *Permian, supra,* 390 U.S. at 787, where the Supreme Court stated:

"The problems and public functions of the small producers differ sufficiently to permit their separate classification, and the exemptions created by the Commission for them are fully consistent with the terms and purposes of its statutory responsibilities. It is not without relevance that this Court has previously expressed the belief that similar arrangements would ameliorate the Commission's administrative difficulties."

pertise[3] not to require small producers to be bound to the area rate and certain filing requirements, on an experimental basis.[4] A higher rate than that previously fixed for the industry in the area may be just and reasonable for the small producer as a separate classification within the area. The Commission is attempting to learn whether under this program the small producers, relieved of much of the burden of regulation required of other classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable, and which will not adversely affect the consumer interests protected by the Act. The Order provides:

> We intend to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking

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[3] Recently, in *FPC* v. *Louisiana Power and Light Co.*, 406 U.S. 621, 642 (1972) the Court referred to the Commission's authority under section 16 of the Act as follows:

"[T]he Commission must possess broad powers to devise effective means to meet these responsibilities. FPC and other agencies created to protect the public interest must be free. 'within the ambit of their statutory authority, to make pragmatic adjustments which may be called for by particular circumstances.' . . . Section 16 of the Act assures the FPC the necessary degree of flexibility. . . . In applying this section, we have held that 'the width of administrative authority must be measured in part by the purposes for which it was conferred. . . . Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.'"

[4] The court is not bound by Commission counsel's response during argument that the Commission could establish a class of "medium" producers for regulation similar to that which Order No. 428 applies to small producers.

> herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect consumers.

The Commission is attempting "to reach an accommodation of conflicting interests, through experimentation, that will result in the proper alleviation of the gas shortage." *Public Service Commission of the State of New York* v. *FPC,* —— U.S.App.D.C. ——, —— F.2d —— (1972).

I do not think the Commission has abdicated its responsibility to insure that rates of small producers will be just and reasonable. It does not appear from the record before us that any such price that might be charged is necessarily unjust or unreasonable. It is the Commission's assumption, given the small percentage of gas sales the small producers account for, and given their situation within the industry, that the rates to be collected from their sales of gas under this new plan will in fact be just and reasonable. The record before us does not rebut this assumption. Moreover, consumer protection is promised, and I cannot now hold that the promise will not be fulfilled. The Commission states:

> The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales. We shall also provide certain other safeguards against unreasonably high small producer prices, as hereinafter discussed, to assure adequate protection of the consumer.

I have considered the contention that Order No. 428 discriminates against large producers vis-a-vis pipelines, but I find in this, as in other contentions

made, no reason to depart from my basic position that as the matter now comes before the court the Order should not be set aside.

I would, however, modify Order No. 428 in one respect. I would strike its provisions prohibiting refunds to pipelines and large producers, leaving open to the Commission to exercise such authority as it has to protect large producers and pipelines in the event the Commission finds they have been charged unreasonably high prices by small producers. As thus modified I would affirm Order No. 428 and its alphabetical series. Should such a modification temper to a degree the charges of small producers, I think that result must be accepted as required by the public interest represented by the Act. I do not think such possible tempering would go so far as to defeat the purposes of Order No. 428.

I respectfully dissent.

## APPENDIX B

United States Court of Appeals for the District of Columbia Circuit

No. 71-1560

TEXACO INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION

No. 71-1561

CONSOLIDATED GAS SUPPLY CORP., PETITIONER

*v.*

FEDERAL POWER COMMISSION

MRS. JAMES R. DOUGHERTY, ET AL., INTERVENORS

No. 71-1603

JAMES M. FORGOTSON, SR., AN INDEPENDENT NATURAL GAS PRODUCER, PETITIONER

*v.*

FEDERAL POWER COMMISSION

MRS. JAMES R. DOUGHERTY, ET AL., INTERVENORS

No. 71-1612

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONER

*v.*

FEDERAL POWER COMMISSION

No. 71–1627

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, PETITIONER

*v.*

FEDERAL POWER COMMISSION

No. 71–1647

WARREN PETROLEUM CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION

No. 71–1722

TENNESSEE GAS PIPELINE CO., PETITIONER

*v.*

FEDERAL POWER COMMISSION

No. 71–1727

PHILLIPS PETROLEUM COMPANY, PETITIONER

*v.*

FEDERAL POWER COMMISSION

No. 71-1729

TEXACO, INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION

*Petition for Review of Orders of the Federal Power Commission*

Before: FAHY, *Senior Circuit Judge,* ROBINSON and WILKEY, *Circuit Judges.*

JUDGMENT

These causes came on to be heard on a Petition for Review of orders of the Federal Power Commission and were argued by counsel. On consideration of the foregoing, it is

ORDERED AND ADJUDGED by this Court that the orders of the Federal Power Commission under review are set aside in accordance with the opinion of this Court filed herein this date.

Per Curiam.

For the Court.

/s/ Hugh E. Kline
HUGH E. KLINE, *Clerk.*

Dated: December 12, 1972.

Opinion by Circuit Judge Wilkey.

Dissenting opinion by Senior Circuit Judge Fahy.

# APPENDIX C

## United States Court of Appeals for the District of Columbia Circuit

No. 71-1560

TEXACO INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
MRS. JAMES R. DOUGHERTY, ET AL., INTERVENORS

No. 71-1561

CONSOLIDATED GAS SUPPLY CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
MRS. JAMES R. DOUGHERTY, ET AL., INTERVENORS

No. 71-1603

JAMES M. FORGOTSON, SR., AND INDEPENDENT NATURAL GAS PRODUCER, 409 BECK BUILDING, SHREVEPORT, LOUISIANA 71101, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
MRS. JAMES R. DOUGHERTY, ET AL., INTERVENORS
TEXACO, INC., INTERVENOR

No. 71-1612

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

No. 71-1612

TEXACO, INC., INTERVENOR

No. 71-1627

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

No. 71-1722

TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

No. 71-1727

PHILLIPS PETROLEUM COMPANY, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
TEXACO INC., INTERVENOR

No. 71-1729

TEXACO INC., PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT

Before FAHY, *Senior Circuit Judge*; ROBINSON and WILKEY, Circuit Judges.

ORDER

On consideration of the petition of the Federal Power Commission for rehearing, and the petition for rehearing filed for Mrs. James R. Dougherty et al., intervenors, it is

ORDERED by the Court that the aforesaid petitions for rehearing are denied.

*Per Curiam*

Senior Circuit Judge Fahy would grant the petitions for rehearing.

# APPENDIX D

## United States of America, Federal Power Commission

[18 CFR 154.91, 154.104, 154.110, 157.40, 250.10, 250.11]

Before Commissioners: JOHN N. NASSIKAS, *Chairman;* LAWRENCE J. O'CONNOR, JR., JOHN A. CARVER, JR., and ALBERT B. BROOKE, JR.

*Exemption of Small Producers From Regulation*

Docket No. R-393

Order No. 428

ORDER ESTABLISHING BLANKET CERTIFICATE PROCEDURE FOR SMALL PRODUCER SALES AND PROVIDING RELIEF FROM DETAILED FILING REQUIREMENTS

(Issued March 18, 1971)

The Commission on July 23, 1970 issued a notice of proposed rulemaking in this proceeding (35 F.R. 12220, July 30, 1970) proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers as defined therein. The proposal did not cover either percentage sales made by small producers pursuant to percentage sales contracts or sales to interstate pipeline companies by their affiliates.

In response to the notice comments were filed by seventy-three parties, including producers, pipeline and distribution companies, associations represent-

ing producer and distributor interests, and the California and New York State Commissions. A conference was also held in this case on December 8, 1970. The small producers support the exemption as originally proposed, while the large producers either oppose such exemption or question its advisability. Pipeline and distribution companies are divided on the issue, with one expressing outright opposition and some of the others suggesting extensive modifications. The American Public Gas Association and the California and New York State Commissions also oppose the proposal.

The small producers argue that traditionally they have been very aggressive in searching for new gas reserves but that such activity has been greatly curtailed in recent years, largely because of restrictive regulation. They further state that their drilling efforts often prove or disprove the presence of gas bearing structures, and that the information gained is useful to all producers, large and small, in their search for new gas supplies. Because of uncertainties in regulated prices, they claim that discontinuation of regulation, rather than higher ceiling prices alone, is necessary to provide the incentive required to encourage a substantial increase in exploratory drilling.

Opponents of the proposed exemption, on the other hand, contend that the proposal will lead to higher natural gas prices for small producer sales resulting ultimately in higher consumer rates. They also disagree with the view that the impact on the consumer will be minimal. In addition, they question the Commission's authority to exempt small producers.

We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no

room for administrative judgment and discretion. Mr. Justice Clark, speaking for the Court in *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964) recommended that the Commission consider procedures for the exemption of small producers. And, in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968), the Court, while recognizing that the language of Sections 5 and 7 is without exception or qualification, noted the power of the Commission under Section 16, for purposes of its rules and regulatons, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By our action herein, we are taking an important step forward to meet this responsibility. Upon review of the contentions made by the various parties, we have decided that both existing and future sales of small producers shall be regulated in the manner hereinafter provided.

Such action should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas. Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the ad-

ministrative burdens connected with processing small producer filings.

We have reviewed the impact of our action on 96 pipelines that purchase gas, based on 1969 statistics in forms 2 and 2–A. This shows, for example, that Kansas-Nebraska's purchases from small producers amount to 21.63% of its total gas supply including purchases from all producers, pipelines and its own production. Comparable percentages for many of the small gather-type pipelines were quite high. However, many of the major pipelines show less than 10%. Others show no purchases at all from small producers. The overall weighted average for the 96 companies was 7.54% (or 10.52% after eliminating all pipeline to pipeline sales).[1]

The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales. We shall also provide certain other safeguards against unreasonably high small producer prices, as hereinafter discussed, to assure adequate protection for the consumer.

We are concerned that favored nation, price redetermination and spiral escalation provisions in small producer contracts may have an adverse impact on consumers. The filing of contracts containing such clauses executed on or after April 2, 1962, has previously been proscribed by the Commission as contrary to the public interest.[2] There is, of course, no objection to the use of these provisions to the extent the result-

[1] These statistics do not include resales to pipelines by large producers of gas purchased from small producers.

[2] Order No. 242, 27 FPC 339; *F.P.C.* v. *Texaco Inc.*, 377 U.S. 33.

ing rate does not exceed the applicable area just and reasonable rate ceiling, as provided in our *Permian* opinion, 34 FPC 159, 236, or, where none is available, the applicable area guideline initial rate ceiling. But these provisions should not be permitted to increase the contract price above such level. To do otherwise would clearly be contrary to the public interest. Consequently, this order will limit the use of these indefinite price escalation provisions by small producers.

The New York Commission contends that the proposed exemption may open the way for large producers to sell their gas in interstate commerce free from Commission regulation by selling their reserves in place to small producers, who would in turn resell the reserves under a conventional (exempt) sales contract to an interstate pipelines. To forestall this possibility, we shall provide that the exemption authorized here for small producers shall not apply to jurisdictional sales made by them where the gas reserves relating thereto were acquired by the purchase of developed reserves in place from a large producer. In such circumstances the small producer will be required to obtain separate certificate authorization.

Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee) in its comments inquired as to whether a pipeline will be assured of recouping its cost of purchased gas if it pays the "going" field price to a small producer. Any question as to the propriety of the price paid by a pipeline to a small producer will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified. The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent. We shall also require pipeline purchasers to file, within 60 days

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of the execution thereof, every new contract or contract amendment for the purchase of natural gas from a small producer whose sale is regulated by the terms of this order.

The exemption proposed in the July 23 notice was applicable, *inter alia,* to sales made by a small producer to a large producer, but not to the resale of such gas by the large producer. A number of large producers argue that if sales by small producers to them are regulated by this order, there is no justification for not also applying consistent treatment to the resale of such gas. They warn that if large producers in these circumstances are not exempt they will be forced to sell gas purchased from small producers under new contracts in intrastate commerce in the future or to forego such small producer supplies, thus limiting the usefulness of their existing gathering and plant facilities. They also point out that if these small producer sales are made directly to an interstate pipeline purchaser under new contracts, it will be necessary for the purchaser to construct new facilities to take such gas which would duplicate existing facilities of large producers. With regard to existing sales, they claim that it would be discriminatory to prevent large producers from increasing their resale rates to account for higher rates paid to small producers.

We think it important to encourage large producers to continue to utilize their existing facilities for the resale in interstate commerce of gas purchased from small producers. For this reason we shall permit large producers with respect to the resale of gas sold to them by small producers pursuant to the subject exemption to file rate increases authorized by contract, thus permitting them to maintain the contract price differential between their purchase and resale prices. These filings shall be accepted, without refund obligation, as

long as the price differential is consistent with prevailing price differentials in the area and as long as the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for by large producers or the prevailing market price for intrastate sales in the same producing area. We shall require large producer purchasers, like pipeline purchasers, to file any new contracts or contract amendments with small producers.

Some of the large producers contend that royalty interests should be excluded specifically from any exemption granted to small producers.[3] We disagree. The royalty interests stand in the same shoes as the working interest owners. Consequently, if a royalty interest relates to a small producer sale, such interest shall be exempt, but if it applies to any other sale it will not be exempt.

Consolidated Gas Supply Corporation (Consolidated) urges that small producers be exempt from compliance with Section 7(b) with respect to the abandonment of their small producer sales only when they have obtained the written consent of the pipeline purchaser to such abandonment. Consolidated points out that the vast majority of these are routine matters occurring either because of depletion of production or because continuance of the sale is uneconomic, and in these situations the purchaser routinely consents to the abandonment. But, Consolidated claims that in the rare situation where there is a dispute as to whether a small producer sale should be discontinued there

[3] The question of this Commission's jurisdiction over royalty interests is now pending before the United States Court of Appeals for the District of Columbia in *Mobil Oil Corporation, et al.* v. *F.P.C.*, Nos. 23463, *et al.*

should be some Commission procedure available for the resolution of such dispute.

We think it important to retain control over all abandonments of jurisdictional sales. For this reason, small producers shall be required to comply with Section 7(b) of the Act with respect to every small producer sale exempted herein.[4] We shall also require purchasers to notify us of the cessation of deliveries by a small producer regulated by the terms of this order within 60 days of such cessation.

Austral Oil Company Incorporated (Austral) suggests that the definition of "affiliated producers" be clarified to make it clear that such term does not include small producers who have participated in joint ventures, nominee agreements and similar contractual arrangements in order to spread the risk of exploration and development and for operating convenience, unless such agreements otherwise establish the power to direct or cause the direction of the management policy of a person. The suggestion is a good one and we shall adopt it.

Tennessee has raised a question as to the applicability of the small producer exemption to a sale by a non-signatory small producer under a large producer's rate schedule. The exemption is applicable to such sale by a small producer.

The Commission proposed in the July 23 notice to waive the provisions of Section 154.63 of the Com-

[4] If a contract for an exempted sale of gas expires and is not extended or replaced by a new contract, the small producer must continue the sale of such gas unless the pipeline consents to abandonment or the producer obtains abandonment authorization. Moreover, in such circumstances the small producer is not entitled to collect any rate in excess of the highest rate permitted under the expired contract for the sale of such gas unless it files a notice of change in rate in accordance with Section 4(d) of the Act.

mission's Regulations to permit the tracking by pipeline purchasers of rate increases resulting from the exemption of small producers in those situations where a purchaser did not otherwise have the right to make a tracking filing. Consolidated claims that the collection of a tracking increase by a pipeline should not be subject to reduction and refund, as provided in the July 23 notice, inasmuch as the small producers will have no potential refund obligation with respect to their increased rates.

Small producers will have no refund obligations with respect to increased rates, if any, collected for sales regulated hereunder to pipelines, and, as a result, pipelines will receive no refunds from small producers to flow through. However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in (1) a pipeline rate case or (2) a proceeding involving only the tracking increase. Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. The Commission shall consider all relevant factors. See *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968); *Austral Oil Co.* v. *F.P.C.,* —— F. 2d —— (Fifth Circuit 1970, slip opinion dated March 19, 1970, No. 27492, et al.) In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests.

Sales from small producers to large producers will likewise carry no refund obligations. However, if the resales by large producers to pipelines reflect new small producer sales at prices in excess of the previously discussed standard, the large producers' rates will be subject to suspension and refund.

Accordingly, the provisions of Section 154.63 are hereby waived to permit pipeline purchasers or pipelines purchasing from such pipeline purchasers to file rate increase applications to track small producer rate increases resulting from the exemption of small producers pursuant to the provisions of this order, provided that pipelines filing such an adjustment submit supporting schedules showing the computation and provided further that such filing may be made only if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or orders, affect the pipeline's average cost of purchased gas by one mill or more. The Commission reserves the right to require a pipeline to file all information required by Section 154.63 if it deems such information to be necessary.

Many of the small producers urge us to relieve them of any potential refund obligations they have under increased rates collected in Section 4(e) rate suspension proceedings or under initial rates collected under temporary certificates issued pursuant to Section 7. These matters more properly should be disposed of in appropriate area proceedings after the refund obligations are determined.

In view of the foregoing, we shall revise Section 157.40 so as to establish a blanket certificate procedure for small producers, applicable to all small producer sales made nationwide under existing and

future contracts.[6] Small producers under this procedure shall be relieved of all filing requirements under the Natural Gas Act and the Commission's Regulations, except for the annual statement required by Section 154.104 of the Regulations and except for compliance with the abandonment provisions of Section 7(b) of the Act. By subsequent order we shall amend Section 250.11 to provide for a revised annual statement to be filed by small producers regulated hereunder commencing in 1972.

Producers who have received small producer certificates prior to the issuance of this order, or who have applied and qualify but have not yet received such a certificate, will not be required to file new applications seeking exemption, unless otherwise directed. Commission orders relating to those small producers who have applied and qualify for a certificate will be issued without any further action on the part of the producers involved. Such certificates, regardless of the date of issuance, will be effective as of 45 days from the date of issuance of this order. Similarly, all of those small producers who file applications for a blanket certificate within 45 days from the date of issuance of this order and who are entitled to coverage thereunder will also receive certificates which will be effective as of 45 days from the date of issuance of this order, regardless of the date of issuance of such certificate. With regard to those producers who have small producer certificates, the existing certificates, without further order of the Commission, shall be deemed to cover, as of 45 days from the issuance of this order, all small producer sales

[6] Notwithstanding the provisions of this order, a small producer may file for the minimum rate authorized by the Commission for any area.

of those producers which are exempt under the provisions of this order. The 45 day period will give the pipeline purchasers and their distribution customers time to track any increases resulting from this action.

We intend to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers.

*The Commission finds:*

(1) The notice and opportunity to participate in this rulemaking proceeding through the submission, in writing, of data, views, comments and suggestions are in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code.

(2) The action taken herein is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modifications adopted herein to the amendments proposed in the notice of this proceeding are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

*The Commission,* acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o, *orders:*

(A) Parts 154 and 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations, are amended as follows:

1. Part 157 is amended by revising Section 157.40 to read:

## § 157.40 Exemption of small producers from certain filing requirements.

(a) ***Definitions.***

(1) A "Small Producer" is an independent producer of natural gas as defined in § 154.91 of this chapter, who is not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with such sales of "affiliated producers" are not in excess of 10,000,000 Mcf at 14.65 psia during any calendar year. As used in this section, the term "jurisdictional sales" includes volumes of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within this section has an interest in such sales, but does not include sales made pursuant to percentage sales contracts.

(2) "Affiliated producers" are persons who, directly or indirectly, control, or are controlled by, or are under common control with, the applicant producer. Such control exists if the producer has the power to direct or cause the direction of, or as a matter of actual practice does direct, the management and policies of another producer, whether such power is exercised alone or through one or more intermediary companies, or pursuant to an agreement, and whether such power or practice is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, relationship of blood or marriage, or any other direct or indirect means. For the further purposes of this section, the term "agreement" shall not include any agreement for the operation of a natural gas producing property or a plant processing natural gas or any joint venture, partnership, nominee, or other type of agreement pertaining

to the joint exploration for and development and operation of oil and gas properties, unless such agreement otherwise establishes the power of one producer to direct or cause the direction of the management and policy of another producer.

(3) "Small producer sales" are (i) sales by a small producer of his own interests under his own contracts; (ii) sales of all interests under a small producer's contract if producers not qualifying as small producers have interests which in the aggregate are no greater than 12½ percent; and (iii) sales of a small producer's interests under another producer's contract.

(b) *Procedure for securing blanket small producer certificate.*

(1) Small producers may apply for a blanket certificate to cover all existing and all future jurisdictional sales that do not raise the producer's total jurisdictional sales on a nationwide basis above 10,000,000 Mcf during any calendar year. Applications by these producers shall include the following information: (i) total jurisdictional sale on a nationwide basis for the year preceding the application; (ii) a list of outstanding certificates and rate schedules together with names and percentage of interest of other interest owners under such rate schedules; (iii) a list of outstanding rate schedules of others in which applicant owns an interest together with applicant's percentage of interest; and (iv) the names of all owners (stockholders, partners, joint venturers, etc.) of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company, any positions such owners may hold with another natural gas company.

(2) An applicant for a blanket certificate who has no outstanding certificate issued by, or rate schedule filed with, this Commission for

the sale of natural gas shall include the following information in his application:

(i) a list of all contracts to sell natural gas in interstate commerce,

(ii) source of production, total rate and the annual volume delivery obligations of the producer under each such contract, together with names and percentage of interest of other interest owners under each such contract, and

(iii) a list of owners of the applicant with an interest of 10 percent or more, their percentage of ownership in the applicant and in any other natural gas company and any position such owners may hold with another natural gas company.

(3) The application shall contain the information required by the form set out in § 250.10 of this chapter. A conformed copy shall be served upon each of the applicant's purchasers.

(c) *Exemption under blanket certificate.* Small producers certificated hereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract. However, no small producer shall be relieved from compliance with Section 7(b) of the Natural Gas Act with respect to any small producer sale exempted hereunder. The exemption authorized herein shall not apply to any jurisdictional sale made by a small producer where the gas reserves relating thereto were acquired by the purchase of developed reserves in place from a large producer.

(d) *Duration of the exemption.* The exemption authorized hereunder shall remain in effect for each small producer until the Commission on its own motion or on application terminates such certificate because the producer no longer qualifies as a small producer or fails to comply with the terms of the exemption. Upon such termination the producer will be required to file separate certificate applications and in-

dividual rate schedules for future sales but the exemption will still be effective as to those made under contracts dated prior to such termination.

(e) *Limitation on contractual provisions.* No Small Producer granted exemption under paragraph (c) above shall charge or collect any rate for a small producer sale of natural gas in excess of the applicable area just and reasonable base rate ceiling, or, where none is available, the applicable area guideline initial rate ceiling, where the contractual right to such rate is based upon any contractual provision which would not be permitted by subsections (a), (b), (b–1) and (c) of Section 154.93. For the purposes of this limitation, it shall make no difference whether the contract was executed prior to or subsequent to April 3, 1962.

(f) *Filings by large producers with respect to related resales.* A large producer may file for the price specified in its related contract for the resale of any natural gas sold to it by a small producer pursuant to the exemption authorized hereunder. Any such rate filing shall be accepted if the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area, and if the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market for intrastate sales in the same producing area.

(g) *Filing of contracts and notification of abandonment.* Pipeline purchasers and large producer purchasers shall file, within 60 days of the execution thereof, each new contract and each contract amendment dated on or after March 18, 1971, for the sale of natural gas to them by a small producer pursuant to the exemption authorized hereunder and shall notify

this Commission of the cessation of deliveries made by a small producer pursuant to the exemption authorized hereunder within 60 days of such cessation.

2. Part 154 is amended by revising paragraph (f) of § 154.91, § 154.104 and § 154.110 to read:

§ 154.91 Applicability.

* * * * *

(f) *Filings by certain non-signatories.* Where the operator and the signatory co-owners in a particular sale are exempt with respect to such sale pursuant to § 157.40, and where any non-signatory co-owner's interests are not covered by such exemption, such co-owner may file rate schedules, rate changes, or certificate applications with respect to such interests notwithstanding the provisions of paragraph (d) of this section.

* * * * *

§ 154.104 Annual statements by small producers.

Annual statements certifying to the matters enumerated in the form set out in § 250.11 of this chapter shall be filed by all producers, either individually or by groups, who have been exempted under the provisions of Section 157.40. The statements shall be submitted by April 1 of each year for the preceding calendar year.

* * * * *

§ 154.110 Applicability of §§ 154.92 through 154.102.

Sections 154.92 through 154.102 shall apply only to those persons specified in § 154.91 and shall not apply to small producer sales which are exempted under § 157.40 of this chapter."

(B) Part 250 of Subchapter G, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising § 250.10 as follows:

The title of § 250.10 is revised to read:

§ 250.10 Application for small producer exemption.

The text of § 250.10 is revised by substituting therefor the form entitled "Application for Small Producer Exemption" as set out in Attachment A hereto.

(C) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

(D) The amendments adopted herein shall be effective 45 days from the date of issuance of this order.

By the Commission:

[SEAL] KENNETH F. PLUMB,
*Acting Secretary.*

§ 250.10

# APPLICATION FOR SMALL PRODUCER EXEMPTION

(See § 157.40(b)(3))

NOTE: Independent Producers of natural gas whose total jurisdictional sales on a nationwide basis for the preceding calendar year, combined with those of "affiliated producers," were not in excess of 10,000,000 Mcf may file the information called for in this form for a Small Producer Exemption to sell gas (in four copies). Include volume of gas paid for but not taken under prepayment clauses or otherwise, and volumes of gas sold under other independent producer rate schedules in the proportion that the independent producer seeking to come within Section 157.40 has an interest in such sales. Do not include sales made pursuant to percentage sales contracts. If insufficient space is given for a complete answer, continue the answer on the reverse side or on a separate sheet, noting the relevant number.

| | |
|---|---|
| 1. NAME OF APPLICANT | 2. STATE OF ORGANIZATION |
| 3. LOCATION OF PRINCIPAL PLACE OF BUSINESS | 4. TYPE OF ORGANIZATION (Corporation, partnership, joint venture, etc) |

5. PERSON RESPONSIBLE FOR APPLICATION

| | |
|---|---|
| NAME AND TITLE | MAILING ADDRESS |

6. TOTAL JURISDICTIONAL SALES VOLUMES AT ______ PSIA FOR CALENDAR YEAR PRECEDING APPLICATION. (If more than one applicant is to be covered by this exemption, give the total jurisdictional sales volumes of each applicant separately.)

7. LIST ALL CERTIFICATES PRESENTLY HELD BY DOCKET NUMBER AND LIST ALL CONTRACTS ON FILE WITH THE COMMISSION AS RATE SCHEDULES BY RATE SCHEDULE NAME AND NUMBER. INCLUDE IN SUCH LISTING APPLICANTS' INTERESTS IN GAS SALES COVERED BY OTHER PRODUCERS' CERTIFICATES AND RATE SCHEDULES. LIST ALL INTEREST OWNERS AND THE AMOUNT OF THEIR INTEREST FOR EACH SALE TO BE COVERED BY THIS EXEMPTION. (See reverse side for reporting)

8. LIST ALL OWNERS OF MORE THAN 10 PERCENT INTEREST IN APPLICANT: (A) INDIVIDUAL NAME; (B) PERCENT OF OWNERSHIP

9. LIST ALL INTEREST OWNED BY THE INDIVIDUALLY NAMED OWNERS IN OTHER NATURAL GAS COMPANIES: (A) INDIVIDUAL NAME; (B) COMPANY NAMES; (C) PERCENT OF APPLICANT OWNERSHIP.

10. LIST FOR EACH OWNER THE POSITIONS HELD BY THESE INDIVIDUAL OWNERS IN APPLICANT COMPANY OR ANY OTHER NATURAL GAS COMPANY.

11. IS APPLICANT OR ANY INDIVIDUAL OWNER LISTED, AFFILIATED WITH ANY PURCHASER OF JURISDICTIONAL GAS FROM APPLICANT? (If so list name of buyer and seller for each sale and nature of affiliation.)

| | | |
|---|---|---|
| SIGNATURE | TITLE | DATE |

FPC Form 314-A
(7-78)

FPC Form 314-A
(7-70)

Attachment A - Pg. 2 of 2

SALES UNDER RATE SCHEDULE OF APPLICANT

| APPLICANT | DOCKET NUMBER | RATE SCHEDULE NUMBER | INTEREST OWNERSHIP UNDER RATE SCHEDULE | |
|---|---|---|---|---|
| | | | NAME | PERCENT INTEREST |

APPLICANTS SALES UNDER RATE SCHEDULE OF OTHERS

| OTHER SELLER | DOCKET NUMBER | RATE SCHEDULE NUMBER | APPLICANTS PERCENT INTEREST IN RATE SCHEDULE |
|---|---|---|---|

NOTE: Place an asterisk (*) after each co-owners name whose interest is not to be covered by the Small Producer Exemption applied for.

# APPENDIX E

## United States of America, Federal Power Commission

[18 CFR 250.11]

Before Commissioners: JOHN N. NASSIKAS, *Chairman;* LAWRENCE J. O'CONNOR, JR., and ALBERT B. BROOKE, JR.

Docket No. R-393

*Exemption of Small Producers From Regulation*

Order No. 428-A

ORDER REVISING ANNUAL STATEMENT

(Issued April 9, 1971)

The Commission on July 23, 1970 issued a notice of proposed rulemaking in this proceeding (35 F.R. 12220, July 30, 1970) proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers as defined therein. Thereafter, the Commission in its Order No. 428 issued March 18, 1971[1] established a blanket certificate procedure for small producers applicable to all small producer sales made nationwide under existing and future contracts.

The Commission indicated in Order No. 428 that by subsequent order it would amend Section 250.11 to

[1] 36 F.R. 5598, March 25, 1971.



501-092—73——5

provide for a revised annual statement to be filed commencing in 1972 by small producers operating under blanket certificates issued pursuant to that general order. The annual statement to be submitted by small producers has been expanded to show, in addition to the total jurisdictional sales volume, a breakdown of such sales by area, volume, purchaser and price.

*The Commission finds:*

(1) The notice and opportunity to participate in this rulemaking proceeding through the submission, in writing, of data, views, comments and suggestions are in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code.

(2) The action taken herein is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modification adopted herein to the amendment proposed in the notice of this proceeding are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

*The Commission,* acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f and 717o, *orders:*

(A) Part 250 of Subchapter G, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising § 250.11 as follows:

The title of § 250.11 is revised to read:

§ 250.11 Annual statement for independent producers holding small producer exemptions.

The text of § 250.11 is revised by substituting therefor the form entitled "Annual statement for independent producers holding small producer exemptions" as set out in Attachment A hereto.

(B) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

(C) The amendment adopted herein shall be effective 30 days from the date of issuance of this order.

By the Commission:

[SEAL] KENNETH F. PLUMB,
*Acting Secretary.*

§ 250.11 ANNUAL STATEMENT FOR INDEPENDENT PRODUCERS HOLDING SMALL PRODUCERS EXEMPTIONS (See § 157.40 of this chapter)

I hereby certify that total sales subject to the jurisdiction of the Federal Power Commission made by the undersigned and its affiliates for the calendar year 19__ were ____________ Mcf at 14.65 psia. The pertinent information relating to each of these jurisdictional sales is as follows:

| *Area* | *Purchaser* | *Volume* | *Price* |
|---|---|---|---|

______________________
(Name of Small Producer)

______________________
(Signed)

______________________
(Representative Capacity)

______________________
(Docket No.)

## APPENDIX F

**United States of America, Federal Power Commission**

[18 CFR 157.39]

Before Commissioners: JOHN N. NASSIKAS, Chairman; LAWRENCE J. O'CONNOR, Jr., JOHN A. CARVER, Jr., ALBERT B. BROOKE, Jr., and PINKNEY WALKER

Docket No. R-393

***Exemption of Small Producers From Regulation***

Order No. 428-B

ORDER MODIFYING ORDER NO. 428 AND DENYING APPLICATIONS FOR REHEARING

(Issued July 15, 1971)

The Commission in Order No. 428 issued March 18, 1971 (36 F.R. 5598, March 25, 1971) in the above-entitled proceeding established a blanket certificate procedure for small producers. Small producers certificated thereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract.

Applications for rehearing of Order No. 428 were filed by James M. Forgotson, Sr. (Forgotson) on March 31, 1971, Mobil Oil Corporation (Mobil) on April 14, 1971, Texaco Inc. (Texaco) on April 15, 1971, Phillips Petroleum Company (Phillips) on April 19, 1971, Warren Petroleum Corporation (War-

ren) on April 16, 1971, Independent Natural Gas Association of America (INGAA) on April 16, 1971, Kansas-Nebraska Natural Gas Company, Inc. (Kansas-Nebraska) on April 19, 1971, Consolidated Gas Supply Corporation (Consolidated) on April 19, 1971, El Paso Natural Gas Company (El Paso) on April 19, 1971, Tennessee Gas Pipeline Company, A Division of Tenneco Inc. (Tennessee) on April 16, 1971, and the Public Service Commission of the State of New York (New York) on April 19, 1971. By order issued April 29, 1971, the Commission provided for joint consideration of these applications for rehearing.

Some of the large producers claim that Order No. 428 casts a burden on them with respect to purchases from small producers which goes beyond the scope of the proposal in the notice issued July 23, 1970 (35 F.R. 12220, July 30, 1970) in this proceeding and is therefore invalid under Section 4 of the Administrative Procedure Act (5 U.S.C. 553).

In the July 23 notice the Commission proposed to apply Section 157.40 of its Regulations, as revised therein, to sales made by a small producer to a large producer, but not to the resale of such gas by a large producer. Under that approach resales by large producers might have been limited to the rate ceiling and any moratorium prescribed by the Commission in each area, but the notice also specifically directed attention to the possibility of a problem in this regard and invited comments with respect thereto.

As a result of the arguments made by certain large producers in thier comments that resales of gas purchased from small producers are entitled to the same treatment as small producer sales, the Commission in Order No. 428 provided relief to the large producers by permitting them to file for contractually authorized rate increases with respect to such resales, regardless

of the ceiling or moratorium which would otherwise be applicable thereto. This modification alleviated some of the problems for large producers inherent in the original proposal, while at the same time providing adequate protection for consumers against unreasonable rates by setting a limitation on the rate level which would be accepted without refund obligation. Our actions, we believe, are in full compliance with the Administrative Procedure Act.

Warren contends it will be faced with the problem of purchasing gas from small producers which must be resold under old contracts containing prices that are not competitive with existing market values.* The order, according to Warren, places a large producer at a disadvantage since a pipeline may negotiate any price at the risk only of such price being found unreasonably high. Warren suggests elimination of this problem by allowing the large producer to pass on the additional cost incurred in the purchase of gas from a small producer under a new contract and to maintain its sales margin, irrespective of any price limitation in its resale contract. We have authority to remove contract price limitations under the *Sierra* doctrine.[1] But, the *Sierra* situation is not presented here. There is, however, nothing to preclude a large producer from renegotiating its resale contract if the purchaser is willing to do so.

Phillips states that even if a large producer is able to negotiate a new resale contract, it is still at a bargaining disadvantage with a pipeline because a pipeline may commence deliveries under budget-type

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*Phillips makes a similar argument in its application for rehearing, and in an amendment to such application for rehearing filed untimely on May 3, 1971, Phillips refers to a specific situation where it is unable to compete with a pipeline purchaser for a small producer sale.

[1] *F.P.C.* v. *Sierra Pacific Power Co.*, 350 U.S. 348.

arrangements as soon as a contract is negotiated with a small producer, while a large producer must wait for Commission action on its certificate application to resell gas under a new contract. Phillips urges the Commission to permit large producers to commence deliveries immediately and thereafter to advise the Commission of the purchase from a small producer and the resale of such gas to a pipeline pending action on its certificate application.

We think it desirable to help large producers maintain their competitive position with pipeline purchasers with respect to purchases of gas under new small producer contracts. Large producers, however, should be required to file a certificate application before commencing the resale of gas under a new contract. Consequently, we shall authorize large producers to resell gas purchased from small producers at any time after they have filed a certificate application pending action thereon, but any amounts collected for such resales in excess of the rate authorized in the certificate case shall be subject to refund with interest.

Mobil claims that Order No. 428 is not clear as to whether the small producer will have a refund obligation on deliveries subsequent to March 18, 1971, where its rate was in effect subject to refund prior to that date or where an above ceiling increase is filed subsequent to that date. The blanket certificate authorized in our order will become effective as of May 2, 1971, at the earliest. Any refund obligation for the period prior to the effective date of a small producer's blanket certificate will be disposed of in the appropriate area proceeding. Consequently, in both of the situations referred to by Mobil, the small producer's rate will be subject to direct Commission regulation at least until May 2, 1971. However, on and

after the effective date of its blanket certificate, the small producer is authorized to collect its contract rate for an existing sale without refund obligation, regardless of the rate on file for such sale prior to the effective date of its blanket certificate and without regard to whether such rate previously was being collected subject to refund.

Suggestions have been made to require small producers to inform their co-owners and purchasers of their status as a small producer. In Order No. 428 small producers were required to serve their purchasers with copies of their applications. Aside from this requirement, we believe large producers and pipeline purchasers are in a better position to acquire and maintain this information as they have been required to do in the past in the Permian, Southern Louisiana and the Hugoton-Anadarko areas. We shall provide some assistance in this regard by appending to this order a list of all small producers who have received small producer certificates or who have applications pending as of April 30, 1971.[2] From time to time we shall update this list.

Small producers who receive blanket certificate authorization are required under Section 157.40(c) to obtain abandonment authorization under Section 7(b) of the Natural Gas Act for any sale made pursuant to Section 157.40. This requirement applies to sales to either large producers or pipelines. It also applies upon the expiration of a new or existing sales contract which provides for termination after a given number of years as well as prior to the expiration of a contract. Nor does it make any difference whether the purchaser consents to the abandonment. Authorization

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[2] The list does not include small producers operating in the Appalachian and Illinois Basin areas.

is required in any event. Footnote 4 relating to abandonment authorization on page 7 of Order No. 428 (p. 5600 of Federal Register Document 71-4044 published at pages 5598-5602 in the issue dated March 25, 1971) is confusing on this latter point and inconsistent with the text on that same page. The words "the pipeline consents to abandonment or" should be deleted from line 4 of that footnote so as to clarify the matter. We shall also modify Section 157.39 of the Regulations (which now provides that Sections 157.23 through 157.30 do not apply to those independent producers who are subject to Section 157.40) to accord with the provisions of Order No. 428. More specifically, we shall make the abandonment provisions of Section 157.30 applicable to small producers covered by Section 157.40.

Consolidated claims there is some confusion as to whether those small producers in the Appalachian and Illinois Basin Areas who automatically received small producer certificates pursuant to Order No. 411 are required to apply for blanket certificates under the new provisions of Section 157.40. They are not so required. As we indicated in Order No. 428, p. 10, small producer certificates previously issued to small producers are deemed to cover as of May 2, 1971 all sales covered under the provisions of Order No. 428. However, any producer initiating service in the Appalachian and Illinois Basin Areas after May 2, 1971, the effective date of Order No. 428, and qualifying as a small producer would be required to file an application for a blanket certificate.

Consolidated also questions whether small producers in the Appalachian and Illinois Basin Areas who have been receiving the minimum rate, without the necessity of filing therefor, in accordance with Order No.

411, in lieu of a lower contract rate, are required as a result of footnote 5 on page 9 of Order No. 428 to make a filing for the minimum rate in that area. Those small producers who have been collecting the minimum rate in that area are not required to make any filing. The purpose of the footnote was not to require a filing where none was previously required, but to make it clear that a small producer would be entitled to the minimum rate authorized by the Commission in each area even though it had a blanket certificate.

New York objects to the provisions of Section 157.40(d) pursuant to which a small producer who exceeds the 10 million Mcf annual limitation retains his status as a small producer until the Commission takes action. New York claims the slippage will be severe. They argue that, as a minimum, the Commission should provide for an automatic termination of the blanket certificate as of the time the cutoff figure is reached. This particular provision is the same as that adopted by the Commission in Order No. 308 after the issuance of the *Permian* decision in Opinion No. 468. There have been no problems under this provision thus far. Indeed, there has been only one instance where a small producer certificate was terminated. We also think it better to determine the appropriate cutoff date when action is taken to terminate the blanket certificate. In our view the use of the automatic cutoff date suggested by New York might cause serious problems for a small producer. Moreover, we think the cutoff date should be the date (April 1) small producers are required each year to report the volume of jurisdictional sales made in the prior year.

Forgotson contends the Commission lacks jurisdiction to issue Order No. 428. This position is based on his contention that the Supreme Court's determina-

tion in the *Phillips* case[3] that this Commission has jurisdiction over sales for resale in interstate commerce by independent producers, while constitutional then, is no longer constitutional.

Forgotson's position is unsound. The Supreme Court, as recently as 1968 in the *Permian Basin Area Rate Cases,* 390 U.S. 747, by its affirmance of the just and reasonable rates determined by the Commission in Opinion Nos. 468 and 468–A reaffirmed by implication, at least, its jurisdictional holding in the *Phillips* case.

It has also been asserted that Order No. 428 is defective because the notice did not advise pipelines that their purchased gas costs relating to new small producer sales would be subject to review.[4] Implicit in this argument is the assumption that, in the absence of these provisions in our order, pipelines would be free to make purchases from small producers under new contracts at imprudent prices. With this assumption, we disagree. Ever since the passage of the Natural Gas Act in 1938, pipelines as regulated public utilities have been permitted to include in their cost of service only those operating expenses, including the cost of purchased gas, which are reasonable. While our order placed emphasis on that duty, it did not effectuate any basic change in the pipelines' obligations in this regard. These obligations would exist even if nothing had been said in the order.

Similar objections to the Commission's standard for limiting a pipeline's reduction and refund obligation

[3] *Phillips Petroleum Co.* v. *State of Wisconsin,* 347 U.S. 672 (1954).

[4] The term "new small producer sale" includes, *inter alia,* gas sold by a small producer pursuant to a contract dated on or after March 18, 1971 which replaces an expired contract or pursuant to a contract amendment dated on or after March 18, 1971, modifying the terms of a contract dated prior to that date.

under a tracking increase are also without merit. The Commission in the July 23 notice proposed to allow pipeline purchasers to file tracking increases of rate increases resulting from the issuance of blanket certificates, but the collection of these tracking increases was to be subject to reduction and refund. In response to Consolidated's claim that the collection should not be so conditioned, the Commission in Order No. 428 modified the original proposal so as to limit the reduction and refund obligation of tracking increases to those which reflect small producer prices for new sales above the standard set forth therein.[5] The standard also provides pipelines with a more concrete guide for their future actions than would exist in the absence thereof. Simply put, the Commission wanted the pipelines to know in advance the boundaries within which they could freely contract with small producers.

Both INGAA and Tennessee object to the provision which limits tracking increase filings to those situations where small producer rate increases, or such increases together with other increases authorized for tracking, affect a pipeline's cost of purchased gas by one mill or more. INGAA urges that a minimum dollar amount be fixed for each company, or, alternatively that the adjustment amount be reduced to one-tenth mill where a pipeline designs its rates to that tolerance. While Tennessee makes no specific recommendation, it does claim that the present limitation is unreasonable for large pipelines. To illustrate, it states that under the present limitation it will be required to absorb all small producer increases until it experiences an overall annual increase of approxi-

[5] There is no reduction or refund obligation with respect to increased purchased gas costs relating to rate increases authorized in existing small producer contracts.

mately $1,200,000 in its purchased gas costs. In view of its many suppliers, its frequent changes in rates and changes in purchase patterns, the limitation imposed is of minor significance. In addition, any reduction in the one mill limitation would substantially increase the number of tracking filings made by a pipeline during the course of a year to the detriment of the pipeline's customers. Consequently we shall retain the one mill limitation.

Tennessee also inquires as to a pipeline's obligation in a situation where the operator of a producing property is a small producer who has a blanket certificate, but one of the non-signatory working interest is a large producer with an interest above 12½%. The large producer in such circumstances is required to obtain certificate authorization under Section 154.91 of the Regulations and to file the small producer's contract as its own as well as its operating agreement with the small producer. If the large producer does not obtain certificate authorization, he is not authorized to make any jurisdictional sales.

In Order No. 428 we indicated that the blanket certificate of a small producer would apply to a sale by a non-signatory small producer under a large producer's rate schedule. Tennessee asserts, however, that if a pipeline pays on the basis of the large producer's billing, it should not later be subjected to claims that the non-signatory small producer who has been selling under the large producer's rate schedule is entitled to a higher rate. For this type of sale a small producer will not be permitted to collect a higher rate than the rate in effect under the large producer's rate schedule for any period prior to the date it notifies the large producer and the pipeline purchaser of its right to make the sale under its blanket certificate and the rate

applicable thereto. However, a small producer who has filed for a small producer or blanket certificate prior to the issuance of this order shall have 30 days from the date of issuance of this order within which to make the notification required herein, and if it does so, such notification shall be effective as of the effective date of its blanket certificate.

Tennessee contends that the Commission's action of providing that the blanket certificate would be effective as of May 2, 1971 if a small producer had filed an application prior to the issuance of Order No. 428 or if it files one on or before May 2, 1971, regardless of the date of Commission action, is illegal because it would result in retroactive increases for small producers. Tennessee also claims the procedure is unfair because there is no way a pipeline can track retroactively the effect of this obligation.

The purpose of our action was to assure the small producer that its effective date for exemption would not depend on the happenstance of the date of issuance of a blanket certificate. Nor is there any retroactivity involved since the filing must be made on or before the effective date. The fact that Commission action will not be taken until after the date of filing does not make the action taken illegal. Such action is similar to the action taken by the Commission on an increased rate filing when it permits such filing to become effective as of the date of filing. Furthermore, there is nothing in Order No. 428 to preclude a pipeline in these circumstances from tracking an increase of this nature.

El Paso has suggested an alternative procedure to the one adopted by us pursuant to which the Commission would take action within 60 days of the submittal of a new small producer contract by a pipeline. Under

this approach the Commission would approve or disapprove the rate proposed, or, alternatively, indicate the proper rate level. During the 60 day review period the small producer would have the right to initiate deliveries without refund obligation and would be free after Commission action to terminate deliveries if it so desired.

The proposal does not go far enough. We want to facilitate the entry of the small producer into the interstate market and to assure the small producer that when he enters into a new contract, the provisions of that contract will not be subject to change. This can best be accomplished within the framework of the procedure we have adopted in Order No. 428.

Nor do we adopt El Paso's request that the first blanket certificates authorized under Order No. 428 be effective as of the first day of a calendar month, in lieu of May 2, 1971, to avoid costly and burdensome procedures in segregating purchases. We are reluctant at this stage to move the effective date back to May 1 and it would be inequitable to the small producers to push it forward to June 1. Moreover, the problems alluded to by El Paso are the same as those which arise each month when a producer places a higher rate into effect, subject to refund.

New York in its application for rehearing sought a stay of Order No. 428 until 30 days after the Commission's action on rehearing based on the assumption that the Commission might rescind or substantially modify that order, but that it might not do so until after May 2, 1971, the effective date of the order. With minor modifications, Order No. 428 remains intact. There is thus no justification for granting a stay now.

A number of other matters have come to our attention which warrant some discussion here. Small pro-

ducer certificates issued pursuant to Order No. 428 will be effective as of May 2, 1971 if an application therefor was filed on or before May 3, 1971,* and as of the date of filing if an application is filed subsequent to May 31, 1971. Following the filing of an application, temporary authorization is not necessary for a small producer to commence new jurisdictional sales or to collect the contract rate for existing or new sales as of May 2, 1971, or the date of filing the application, whichever is applicable. The blanket certificate, when issued, will provide all of the necessary authorization.

As provided in Order No. 428, those producers who received small producer certificates under the procedure in effect prior to the establishment of the new procedure in Order No. 428 are deemed as of May 2, 1971, without further order of the Commission, to have blanket certificate authorization under Section 157.40 (c) as now constituted.

In accordance with Order No. 428, small producers under favored-nation or other indefinite pricing clauses may charge the applicable area just and reasonable ceiling. The vintage of the gas involved will determine whether a small producer is entitled to the new or old gas ceiling. Where no just and reasonable determination is available, a small producer may charge the applicable area guideline initial rate ceiling, regardless of the vintage involved.

Finally, the blanket certificate authorization is applicable to jurisdictional sales made by a small producer from gas reserves acquired prior to the issuance of Order No. 428 by the purchase of developed reserves in place from a large producer. The problem sought to be solved in Section 157.40(c) by the exclusion from

* Inasmuch as the filing deadline fell on May 2, a Sunday, it was extended to May 3 pursuant to Section 1.13 of the Commission's Rules of Practice and Procedure.

blanket authorization of sales from certain gas reserves has no applicability to previously acquired reserves. However, for acquisitions of developed reserves in place made on or after the issuance of Order No. 428, a small producer must apply for separate certificate authorization for jurisdictional sales relating thereto regardless of whether the large producer who sold the reserves in place retained any rights or reversionary interest in the properties involved.

*The Commission finds:*

(1) The applications for rehearing set forth no further facts or principles of law which were not fully considered in Order No. 428 (36 F.R. 5598, March 25, 1971), or which, having now been considered, warrant any modification of that order, except as hereinafter provided.

(2) The correction of footnote 4 in Order No. 428 (36 F.R. 5598 at 5600, March 25, 1971) and the revision of Section 157.39 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.39) prescribed in ordering paragraphs (B) and (C), *infra*, constitute a clarification and interpretation of Order No. 428, an existing order in this proceeding which was adopted in compliance with the requirements of 5 U.S.C. 553 after notice and opportunity to submit written comments which were received and considered by the Commission. Accordingly, further compliance with the notice, public procedure and effective date requirements of 5 U.S.C. 553 is unnecessary.

(3) The correction of footnote 4 in Order No. 428 (36 F.R. 5598 at 5600, March 25, 1971) and the revision of Section 157.39 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.39) prescribed in ordering paragraphs (B) and (C), *infra*, are necessary and appropriate for carrying out the provisions of the Natural Gas Act.

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(4) Since the addition of paragraph (h) to Section 157.40 of the Commission's Regulations under the Natural Gas Act (18 CFR 157.40) prescribed in ordering paragraph (D), *infra,* is consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

*The Commission,* acting pursuant to the provisions of the Natural Gas Act, particularly Sections 4, 5, 7, 16 and 19, 52 Stat. 822, 823, 824, 825, 830 and 831; 56 Stat. 83, 84; 61 Stat. 459; 15 U.S.C. 717c, 717d, 717f, 717o, 717r,

*orders:*

(A) The applications for rehearing filed with respect to Order No. 428 (36 F.R. 5598, March 25, 1971) and New York's request for a stay are denied.

(B) Federal Register Document 71–4044 published at pp. 5598–5602, Vol. 36, of the issue dated Thursday, March 25, 1971, is corrected by deleting the words "the pipeline consents to abandonment or" in lines 4–5 of footnote 4, which footnote appears on p. 5600 at the bottom of the left-hand column.

(C) Part 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations is amended by revising Section 157.39 to read:

§ 157.39 Applicability of §§ 157.23 through 157.30

Sections 157.23 through 157.30 shall be applicable to independent producers as defined in § 154.91 of this Chapter, but, with the exception of § 157.30, shall not apply to those independent producers who are subject to §157.40.

(D) Part 157 of Subchapter E, Chapter I, Title 18 of the Code of Federal Regulations is amended by adding paragraph (h) to Section 157.40, as follows:

§ 157.40 Exemption of small producers from certain filing requirements.

* * * * *

(h) *Resale authorization for large producer.* A large producer who has filed on or after ____________, 1971, an application for a certificate of public convenience and necessity for the resale of natural gas purchased from a small producer authorized to sell such gas pursuant to the blanket certificate provisions in paragraph (c) above may resell such gas at any time after the filing of its certificate application pending final Commission action thereon. Any amounts collected by a large producer for resales made pursuant to this paragraph in excess of the rate finally determined to be required by the public convenience and necessity for such resales shall be subject to refund with interest at 7 percent per annum.

(E) This order shall be effective upon issuance.

(F) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission:

[SEAL] KENNETH F. PLUMB,
*Secretary.*

## APPENDIX

*Small Producer Certificates, April 30, 1971*

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| A. I. K. Ltd. | CS71-108 | | |
| A. I. K. Ltd. No. 2 | CS71-106 | | |
| A-L Ltd. | CS71-120 | | |
| Abell, George T. | CS66-109 | 06-14-66 | |
| Abercrombie, A. L. | CS71-71 | | |
| Abercrombie, J. S. Mineral Company, Inc. | CS71-378 | | |
| Ackers, D. E. | CS68-6 | | Terminated 11-29-67 |
| Acme Oil Corporation | CS71-204 | | |
| Ada Oil Company | CS66-78 | 06-14-66 | |
| Adams, K. S., Jr. | CS66-17 | 06-14-66 | |
| Adams, K. S. Jr. d/b/a Rio Hondo Oil Company | CS66-80 | 06-14-66 | |
| Adams & McGahey | CS71-220 | | |
| Adams Production Company | CS66-79 | 06-14-66 | Terminated 04-02-69 |
| Adams, R. W. & Son | CS71-219 | | |
| Adobe Corporation | CS71-250 | | |
| Adobe Ltd. #1 | CS69-73 | 09-16-69 | |
| Adobe Ltd. #2 | CS69-74 | 09-16-69 | |
| Adobe Investment Corp. | CS69-75 | 09-16-69 | |
| Adobe Oil Company | CS67-2 | 09-27-66 | |
| Aikman Brothers | CS71 109 | | |

*A blank space in the "Order Issuing CS Cert." column indicates "certificate not issued as of April 30, 1971".

***Small Producer Certificates, April 30, 1971*—Continued**

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Aikman Bros., Corporation | CS71-107 | | |
| Aikman, Claude E. | CS66-63 | 07-20-66 | |
| Akin, H. D. | CS71-327 | | |
| Aladdin Production Co | CS69-23 | | |
| Alamo Petroleum Company | CS71-361 | | |
| Allbritton, Carolyn E. | CS71-384 | | |
| Allen, R. C. | CS71-215 | | |
| Alliance Oil & Gas Company | CS71-79 | | |
| Alpine Oil Company | CS71-165 | 02-17-71 | |
| Amarex, Inc. | CS71-92 | | |
| Ambrose, Z. C. | CS66-32 | 07-20-66 | |
| American Gas Engineering, Inc. | CS71-227 | | |
| American Trading & Production Corp. | CS66-76 | 04-22-66 | |
| Americana Oil & Gas Properties of Texas Inc. | CS68-55 | | Returned 07-23-68 |
| Amini Oil Corporation (Formerly K. K. Amini) | CS68-1 | 08-30-67 | |
| Anchor Production Co. | CS71-394 | | |
| Anderson, Bruce | CS71-19 | 02-05-71 | |
| Anderson, E. D. | CS71-4 | 09-21-70 | |
| Anderson, E. T | CS68-7 | 11-20-67 | |
| Anderson, J. S., Jr. | CS70-3 | 09-16-69 | |
| Anderson Petroleum | CS71-121 | | |
| An-Son Corporation | CS69-77 | 09-08-69 | |
| Antwell, Morris R. | CS66-27 | 04-08-66 | |
| Apco Oil Corporation | CS66-1 | 04-11-66 | |
| Appleby, M. P., Jr. | CS70-1 | 09-16-69 | |
| Appleman, Nathan | CS71-60 | | |
| Aquitane Oil Corporation | CS71-281 | | |
| " " " | CS71-543 | | |
| Archer and Smith | CS71-373 | | |
| Ard Drilling Company | CS66-118 | 07-20-66 | |
| Ares, A. L. | CS67-31 | 03-13-67 | |
| Ares, Sam D. | CS66-46 | 04-08-66 | |
| Areus Production Company (Formerly First National Bank in Dallas, as Trustee for Paul P. and Clara T. Scott) | CS66-22 | 06-14-66 | |
| Armstrong, Robert C. | CS71-146 | | |
| Arnold, Daniel C. | CS71-428 | | |
| Arroya Resources Inc. | CS71-388 | | |
| Ashmun & Hilliard | CS66-130 | 06-07-66 | |
| Atkinson, Dora C. | CS71 532 | | |
| Avance Oil & Gas Company, Inc. | CS70-28 | 02-02-70 | |
| Axelrod, Beverly M. | CS71-133 | | |
| Axelrod, Kenneth M. | CS71-132 | | |
| Mamie Axelrod Estate | CS71-134 | | |
| Aycock, William P. & Hillin, Robert K., d/b/a Aycock & Hillin | CS69-43 | 06-01-69 | |
| Aztec Gas Systems, Inc. | CS70-20 | 11-10-69 | |
| B B M Drilling Company | CS67-51 | | Returned 06-22-67 |
| B H & D Company | CS67-54 | 07-20-67 | |
| BTA Oil Producers | CS69-12 | 03-05-69 | |
| BWP, Inc. | CS67-91 | 07-07-67 | |
| Bakke, W. E. | CS66-11 | 07-20-66 | |
| Bakke, W. E. d/b/a W. E. Bakke Oil Company | CS71-18 | | |
| Baldridge, B. | CS71-188 | | |
| Bankers Trust Company Trustee | CS66-8 | 05-11-66 | |
| Barker, Shannon | CS71-155 | | |
| Barnes, Florence H. Trustee | CS70-11 | 10-08-69 | |

* See footnote on p. 65a.

## *Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Barnes, J. C. Oil Company | CS67-1 | 09-27-66 | |
| Barnett, Gladys Lucille | CS67-11 | 12-20-66 | |
| Barnett Oil Company | CS71-210 | | |
| Barnett, Thomas D. | CS67-12 | 12-20-66 | |
| Barnett-Serio Exploration Company | CS70-38 | 07-20-70 | |
| Barnhart, Paul F. | CS66-77 | 10-25-66 | |
| Barnhart, Paul F. Trustee | CS67-52 | 06-22-67 | |
| Baruch-Foster Corporation | CS68-48 | 06-17-68 | |
| Bass, H. W. & Sons Inc. | CS71-437 | | |
| Bayless, Robert L. | CS71-413 | | |
| Beach, R. G. Mrs. | CS67-74 | 06-07-67 | |
| Bean, R. J. | CS71-222 | | |
| " " " | CS71-309 | | |
| Beard, Doris A. | CS66-75 | 07-20-66 | |
| Becker, Phillip F. | CS66-31 | | Rejected 01-07-66 |
| Beker, Erol | CS70-21 | 11-10 69 | |
| Bel Oil Corporation | CS71-516 | | |
| Bell Petroleum Company | CS68-15 | 04-18-68 | |
| Belgam Oil Company | CS71-418 | | |
| Benedum-Trees Oil Company | CS66-18 | 07-20-66 | |
| Beneficial Oil Company | CS71-3[illegible] | | |
| Benish, Bess Jo | CS71-494 | | |
| Mills Bennett Estate | CS71-341 | | |
| Bettis, Boyle & Stovall | CS71-127 | 01-18-71 | |
| Bickel, Ross R., Trustee | CS66-126 | 08-11-66 | |
| Bintliff, David C. | CS71-422 | | |
| Blackrock Oil Company | CS70-49 | 08-24-70 | |
| Blakeney, Dorothy Hewit, et al. | CS71-454 | | |
| Blanks, W. C. | CS71-540 | | |
| Bodcaw Company | CS71-304 | | |
| Bogle, Hal | CS66-45 | 07-20-66 | |
| Bogle Farms, Inc. | CS66-4 | 04-06-66 | |
| Bond, Roland S. | CS71-106 | | |
| Bonray Oil Company | CS71-461 | | |
| Bowen, Sam | CS67-33 | 04-04-67 | |
| Bourg, Oscar Estate of (Formerly MEB Oil Company) | CS68-5 | 08-28-67 | |
| Bowers Drilling Company, Inc. | CS71-51 | | |
| Boyd, Walter K., Jr. | CS69-67 | 09-16-69 | |
| Boyle, W. Stewart | CS67-7 | 11-14-66 | Will be Cancelled |
| Brack, Ben F. | CS71-73 | | |
| " " " | CS71-274 | | |
| Bradley, Albert | CS68-8 | | Dismissed 11-20-67 |
| The Bradley Producing Corporation | CS71-23 | | |
| Brady, Austin d/b/a Brady Compressing Company | CS71-167 | | |
| Brumm, M. W. | CS67-36 | 03-13-67 | |
| Bright & Schiff | CS71-70 | | |
| Britain, B. M. | CS71-24 | | |
| Brokaw, Edwina S. | CS68-9 | 11-20 67 | |
| Bromley, Jane P. | CS71-500 | | |
| Bromley, W. K. | CS71-488 | | |
| Bruce Oil Corporation | CS67-99 | 08-30-67 | |
| Brookhaven Oil Company | CS71-293 | | |
| Brooks Gas Corporation | CS66-73 | | Withdrawn 07 14 66 |

See footnote on p. 65a.

## *Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Brooks Gas Corporation | CS66-89 | | Withdrawn 07-14-66 |
| " " " | CS67-47 | | Withdrawn 10-01-68 |
| Brown, C. Arnold OEA | CS71-412 | | |
| Brown, Elizabeth M. | CS67-68 | 05-23-67 | |
| Brown & Key, Inc. | CS66-36 | 03-28-66 | |
| Brown, Robert T. | CS71-5 | 09-21-70 | |
| Bruns, H. D. | CS71-493 | | |
| Buckles, George L. | CS66-119 | 07-20-66 | |
| Burdette, Hugh | CS71-216 | | |
| Burdette, Hugh & H. L. Green Trustee | CS71-217 | | |
| Burk Gas Corporation | CS71-7 | 11-04-70 | |
| Burleson, Lewis B. & Huff, Jack | CS69-36 | 04-15-69 | |
| Burlington Bank and Trust Company | CS71-340 | | |
| Burnett Corporation | CS71-86 | | |
| Burnett, H. N. | CS71-87 | | |
| Burns, John J. | CS68-10 | | Dismissed 11-20-67 |
| Burns Trust #2 | CS71-519 | | |
| Burns Trust #3 & 1 | CS71-518 | | |
| Buxton, P. M. | CS71-130 | | |
| Byrom, W. K. | CS66-37 | 04-08-66 | |
| " | CS71-334 | | |
| C. W. Inc. | CS71-271 | | |
| CRA, Inc. | CS67-76 | 07-07-67 | Terminated 09-21-69 |
| Cactus Drilling Company | CS66-54 | 04-08-66 | |
| Cahill, John T. | CS68-11 | | Dismissed 11-20-67 |
| Cahoon, Frank Kell | CS69-81 | 10-15-69 | |
| Calco, Inc. | CS68-47 | 04-18-68 | |
| California Time Petroleum, Inc. | CS71-141 | 02-05-71 | |
| Cal-Ray Petroleum Corp. | CS71-323 | | |
| Calvert Exploration Company | CS71-51 | | |
| Calvert Western Exploration Co. | CS70-41 | 07-07-70 | |
| Campbell, Donald C. | CS69-66 | 09-16-69 | |
| Campbell, E. R. | CS71-306 | | |
| Campbell, Pearl G. | CS71-218 | | |
| Cantwell, Dallas | CS69-76 | 09-16-69 | |
| Carlson, Everett J., Oper. | CS71-390 | | |
| Carr, W. P. | CS71-397 | | |
| Carter, R. W. | CS68-32 | 12-15-67 | |
| Caruthers, John D. | CS71-319 | | |
| Caruthers Operating Company Inc. OEA | CS71-338 | | |
| Caruthers, Dr. Robert Mack | CS71-336 | | |
| Caruthers, Vera O. | CS71-337 | | |
| Cass, Frank W. | CS68-41 | 04-02-68 | |
| Cassidy, Thomas (Mrs.) | CS66-129 | 08-11-66 | |
| Caulkins, George P., Jr. | CS71-388 | | |
| Cellhardt, M. A./S. J. | CS71-410 | | |
| Chalmers, David B. | CS69-96 | 09-16-69 | |
| Chambers & Kennedy | CS71-41 | 03-13-67 | |
| Champlin Exploration Inc. | CS71-251 | | |
| Champlin, H. H., et al. | CS71-252 | | |
| Chandler & Associates Inc., et al | CS71-350 | | |
| Chandler-Simpson Inc., et al. | CS71-333 | | |
| Chanslor—Western Oil & Development Company | CS71-208 | | |
| Chapell, Don O. | CS68-49 | 06-06-68 | |
| Chapman & Poland | CS66-44 | 04-08-66 | Terminated 07-07-70 |
| Charm Oil Company | CS66-29 | 06-14-66 | |
| " " " | CS71-308 | | |

See footnote on p. 65a.

*Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Cherry, A. W. Trust | CS68-44 | 06-05-68 | |
| Cherry, Estate of J. Blair | CS71-253 | | |
| " " " " | CS71-426 | | |
| Childers Oil Company | CS71-201 | | |
| Childers, Jay Oil Company | CS71-202 | | |
| Christmann, John J. | CS67-80 | 07-28-67 | |
| Circo Exploration Inc. | CS71-550 | | |
| Clark, E. B. | CS66-136 | 08-11-66 | |
| Clark Fuel Producing Co. | CS71-438 | | |
| Clark Oil Producing Company | CS71-447 | | |
| Clayton, Earl | CS71-38 | | |
| " " | CS71-40 | | |
| Clayton, Helen J. | CS71-37 | | |
| Clayton-Dwyer Drilling Co. | CS71-36 | | |
| Cline, W. S. | CS71-117 | | |
| Close, G. M. | CS71-466 | | |
| Close, G. M. Company, Ltd. | CS71-465 | | |
| Coates, George H. | CS71-317 | | |
| Cobb, Dalton H. | CS66-61 | 06-14-66 | |
| Cochran, Phil K. | CS71-460 | | |
| Coll, Max W. II & The Estate of James R. Stephens | CS69-34 | 04-15-69 | |
| Collinsworth, A. E. | CS71-501 | | |
| Columbia Oil Corporation | CS69-10 | 12-03-68 | |
| Commercial National Bank in Shreveport, Trustee | CS71-443 | | |
| Compression Company of Oklahoma, Inc. | CS70-44 | 07-07-70 | |
| Comps, Inc. | CS71-137 | | |
| Cone, J. R. | CS66-69 | 07-20-66 | |
| Cone, S. E. | CS66-71 | 07-20-66 | |
| Connally Oil Company, Inc. | CS66-129 | 08-11-66 | |
| Conover, William V. | CS69-19 | | |
| Consolidated Gas and Equipment Company of America | CS71-358 | | |
| Consolidated Production Corp. | CS71-538 | | |
| Constantin, E., Jr. | CS67-73 | 06-22-67 | |
| Continental-Emsco Company, a Division of Youngstown Sheet & Tube Co. | CS69-3 | 10-14-68 | |
| Cook, William H. Deceased et al. | CS71-445 | | |
| Coppinger, W. J. | CS71-308 | | |
| Coppock, Herbert L. & Coppock, Stanley, Jr. | CS71-52 | | |
| Coquina Oil Corporation | CS66-101 | 07-20-66 | |
| (Formerly McGrath & Smith) | CS71-147 | | Cancelled 3 18-71 |
| Coral Gas and Oil, Inc. | CS71-28 | | |
| Cornell Oil Company | CS67-49 | 04-25-67 | |
| Cornutt, Dona P. | CS71-243 | | |
| Corpus Christi Leaseholds, Inc. | CS71-435 | | |
| Cotner, Bill C. d/b/a Meadco Properties (Formerly Meadco Properties Ltd.) | CS67-18 | 11-14-66 | |
| Cotton Petroleum Company | CS71-322 | | |
| Courtney, E. A., Agent | CS71-505 | | |
| Cowper Brothers Production Co. | CS66-131 | 08-11-66 | |
| Cox, John L. | CS66-65 | 06-07-66 | |
| Crawford, H. Victor | CS71-492 | | |
| Crawford, John L. | CS71-6 | 12-11-70 | |
| Cree Oil Inc. | CS71-549 | | |
| Crouch, Louis | CS66-95 | 04-22-66 | |
| Cruse, Pauline F. Vancleve | CS71-408 | | |
| Crystal Oil Company | CS71-530 | | |

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## *Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Culbertson, E. A. & Irwin, Wallace W. | CS67-58 | 05-23-67 | |
| D.D.I., Inc. | CS71-182 | 03-18-71 | |
| DST Exploration Corporation | CS69-2 | 10-14-68 | |
| Dacresa Corporation | CS71-264 | | |
| Dalco Oil Company | CS66-96 | 07-20-66 | |
| Dale, Cloris | CS71-142 | | |
| Dalport Oil Corporation | CS66-15 | 06-14-66 | |
| Dameron, W. Frank | CS71-205 | | |
| Damson Exploration Corp. | CS69-40 | 06-04-69 | |
| Danden Petroleum, Inc. | CS71-231 | | |
| Darmac Corporation | CS66-99 | 08-15-66 | Terminated 09-17-69 |
| Darnielle, George J. | CS67-71 | 06-22-67 | |
| Darrow, Ann W. | CS66-35 | | Rejected 01-07-66 |
| Daubert, Charles A., Oper. | CS71-273 | | |
| Davidson, William A. | CS69-49 | 07-25-69 | |
| Davis Drilling Inc. | CS71-277 | | |
| Davis, K. W. | CS67-63 | 07-24-67 | |
| Davis, Rebecca | CS70-7 | 09-17-69 | |
| Davison, Leland, Estate of (Formerly Davison, Leland) | CS66-64 | 06-07-66 | |
| Davon Drilling Company | CS71-206 | | |
| Davoust, Richard C. | CS66-68 | 06-14-66 | |
| Dawson, Bobbie G. | CS71-129 | | |
| Dean, Betty M. | CS71-226 | | |
| Dean, Edwin A. | CS69-52 | 07-25-69 | |
| Dean, Robert A. | CS68-43 | 04-18-68 | |
| Deas, Rutledge H., et al. | CS71-353 | | |
| Deck Oil Company | CS71-228 | | |
| Deck, Millard Oil Company | CS69-18 | 01-21-69 | |
| DeCleva, Paul | CS67-13 | 12-20-66 | |
| DeJean, Mrs. Doris Gamble | CS71-507 | | |
| Delta Corporation | CS71-194 | | |
| Depco, Inc. | CS67-16 | 01-17-67 | |
| Dillard, A. R. | CS71-171 | | |
| Dixilyn Corporation (Formerly Dixilyn Drilling Corp.) | CS69-25 | 02-24-69 | |
| Dixon Management Corporation | CS71-485 | | |
| Dominion Oil & Gas Co. | CS71-332 | | |
| Donnell Drilling Company | CS71-533 | | |
| Dougherty, Mrs. James R., et al. | CS71-446 | | |
| Douglas, L. A. | CS71-301 | | |
| Dow Chemical Company, The | CS71-318 | | |
| Dual Production Company | CS66-163 | 05-24-66 | |
| Dubose, Frank F. | CS71-49 | | |
| Duncan Drilling Company | CS67-59 | 06-22-67 | |
| Duncan, J. Walter Jr. | CS68-12 | 11-20-67 | |
| Duncan, Raymond T. | CS68-13 | 11-20-67 | |
| Duncan, Vincent J. | CS68-14 | 11-20-67 | |
| Duncan, Walter | CS68-15 | 11-20-67 | |
| Dunigan, James B., Estate | CS71-212 | | |
| Dunigan, James P., Trust | CS68-24 | 10-25-67 | |
| Dunigan, E. J., Jr. | CS71-59 | | |
| Dunigan, E. J., Jr., Trustee | CS71-58 | | |
| Dunn & Attebury | CS71-162 | | |
| Dwyer, Robert F. | CS69-80 | 09-16-69 | |
| Dykes, J. A. | CS71-553 | | |
| Dyna Ray Oil & Gas Co., Inc. | CS71-539 | | |

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## *Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Echols, W. H. | CS70-8 | 09-17-69 | |
| Ego & Grease | CS70-17 | 11-10-69 | |
| Eisenbegan, Benjamin | CS71-298 | | |
| Elkins, George W., Jr. | CS67-102 | 08-28-67 | |
| Elliott & Hall | CS67-98 | 07-28-67 | |
| Elliott Oil, Inc. | CS67-92 | 07-28-67 | Terminated 09-12-67 |
| Elliott, Frank O. d/b/a Elliott Oil Co. (Formerly Elliott Production Co.) | CS67-94 | 07-28-67 | |
| Emerald Oil Company | CS71-478 | | |
| Empire Oil Company | CS71-497 | | |
| Enfield, Robert N. | CS67-60 | 06-23-67 | |
| Eppenauer, A. R. | CS67-63 | 07-07-67 | |
| Equipment Inc. | CS71-511 | | |
| Evans, Nelson B. | CS71-398 | | |
| Estes, Martha Clayton | CS71-39 | | |
| Estrella Oil Company | CS70-27 | 03-10-70 | |
| Etchieson & Gross Associates | CS71-119 | | |
| Euramerica Partnership 69 | CS71-156 | | |
| Evko Development Company | CS71-347 | | |
| Expando Production Co. | CS71-377 | | |
| Expler Company | CS70-61 | 09-21-70 | |
| FTF Gas Corporation | CS66-62 | 08-11-66 | |
| Farr, Carolyn E. (Gribble) | CS71-455 | | |
| Farr & Gribble, et al. | CS71-456 | | |
| Farr, P. P. Douglas | CS71-443 | | |
| Farrar, Fletcher F. | CS70-24 | 04-13-70 | |
| Fassel, W. C., Estate OEA | CS71-296 | | |
| Fellers, W. J. | CS71-65 | | |
| Ferguson Oil Company Inc. | CS71-228 | | |
| Ferguson, W. B., III | CS71-498 | | |
| Fields, Bert, Estate (Now Fields, Bert, Jr.) | CS66-122 | 07-20-66 | Succession 3-18-71 |
| Fields, Bert, Jr. (Formerly Bert Fields Estate) | CS66-122 | 07-20-66 | |
| | CS71-297 | | |
| Fikes, Leland, Estate of Deceased | CS67-64 | 07-24-67 | |
| First National Bank of Amarillo, Trustee Betty Tell Trust | CS71-439 | | |
| First National Bank in Bartlesville | CS71-230 | | |
| First National Bank of Dallas as Trustee for Paul P. & Clara T. Scott (Now Argus Production Company) | CS66-22 | 06-14-66 | Substituting Argus 08-12-68 |
| First National Oil, Inc. | CS71-387 | | |
| Fishman, Felix A., et al. Trustees (Formerly Estate of William L. Hernstadt, Deceased) | CS66-9 | 05-11-66 | |
| Five Resources, Inc. | CS70-22 | 04-07-70 | |
| Flag Oil Corp. of Delaware | CS67-65 | 07-24-67 | |
| Fleet, Howard W. | CS68-34 | 12-12-67 | |
| Flexr Corporation | CS66-128 | 08-11-66 | |
| Forea Company | CS66-61 | 08-11-66 | |
| Forse, R. L. | CS66-83 | 07-20-66 | |
| Fort Worth National Bank Trustee | CS69-6 | 12-03-68 | |
| Foster Petroleum Corporation | CS71-74 | | |
| Fowler, Tom D. & McDaniel, R. G. d/b/a Fowler & McDaniel | CS69-42 | 06-04-69 | |
| Fox, Grady L. | CS71-64 | | |
| Fox, James O. Jr. | CS67-26 | 05-04-67 | |
| Fraley Oil Company, Inc. | CS71-411 | | |
| Francis Oil and Gas Inc. | CS71-109 | | |

See footnote on p. 65a.

*Small Producer Certificates, April 30, 1971—Continued*

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
| --- | --- | --- | --- |
| Franke, Albert, III | CS69-60 | 07-25-69 | |
| Franklin, John M. | CS68-16 | | Dismissed 11-20-67 |
| Frasse, P.C. | CS71-170 | | |
| Freeport Oil Company | CS69-6 | 12-08-68 | |
| French, L. R., Jr. | CS67-105 | 01-22-68 | |
| Frost, Jack, The Estate of | CS71-478 | | |
| Fuhrman, F. H. | CS68-53 | 08-12-68 | |
| Fuller, Rex | CS71-197 | | |
| Fuller, R. P. | CS71-198 | | |
| Fulton, R. H. | CS67-34 | 03-01-67 | |
| The Fundamental Oil Corp. | CS70-47 | 08-24-70 | |
| " " " " | CS71-9 | | Cancelled 09-08-70 |
| G. H. K. Corporation | CS71-349 | | |
| GMC Oil & Gas Corporation | CS71-467 | | |
| Gackle, Albert | CS66-10 | 07-20-66 | |
| Gallagher, C. R., Jr. | CS66-31 | 04-08-66 | |
| Galloway, W. W. | CS71-290 | | |
| Garlitz, C. Gary | CS68-98 | 05-05-68 | |
| Gas Gathering Corporation | CS71-506 | | |
| Gasco, Inc. | CS71-136 | | |
| Gates, A. P. | CS69-95 | 09-16-69 | |
| Gear, R, James | CS71-112 | | |
| Gentry, James U. | CS69-60 | 08-18-69 | |
| Geochemical Surveys | CS71-10 | 11-23-70 | |
| Gibbons, Ed | CS71-289 | | |
| Gifford, J. N. | CS71-189 | | |
| Gifford & Mitchell | CS71-190 | 03-18-71 | |
| Ginsburg, Arthur I. | CS69-64 | 09-16-69 | |
| Ginther, Warren and Company | CS71-6 | 11-23-70 | |
| Global Oils, Inc. | CS71-82 | | |
| Glover Hefner Kennedy Oil Company | CS71-128 | | |
| Goldston, Iris & Goldston, W. J. Successor Trustee for Walter L. Goldtagn Trust | CS70-5 | 09-16-69 | |
| Goodrich, John S. | CS70-43 | 07-30-70 | |
| Gould, George D., Trustee | CS67-30 | 04-26-67 | |
| Grace, Corinne | CS71-161 | 02-17-71 | |
| Grace, Joseph Peter | CS68-17 | | Dismissed 11-20-67 |
| Graham, Bill J. | CS67-45 | 04-04-67 | |
| Graham, George W., Inc OKA | CS71-294 | | |
| Graham Michaelis Drilling Company and Sierra Petroleum Co. Inc. | CS71-178 | | |
| Grammer, Jessica | CS69-94 | 09-16-69 | |
| The Gray Wolfe Company | CS71-314 | | |
| Greany, Rosemary Hale | CS69-11 | 12-16-68 | |
| Great Western Drilling Company | CS66-124 | 07-20-66 | |
| Greathouse, Pierce & Davis | CS67-101 | 07-28-67 | |
| Green, E. L., Jr. | CS71-214 | | |
| Green, G. W. | CS71-45 | 01-18-71 | |
| Greenbrier 64 Limited | CS67-39 | 03-13-67 | |
| Greenlee, Melba Jean Davis Executrix Est. of Geraldine T. Davis | CS70-6 | 09-17-69 | |
| Gribble & Hartman | CS71-480 | | |
| Grogan, Doyle T. | CS71-284 | | |
| Grover, MacCurdy & Hoffacker | CS66-105 | 06-14-66 | |
| Gruenerwald, William | CS71-242 | | |
| William Gruenerwald & Associates Inc. | CS71-241 | | |
| Gruy Management Service Company Agent for Cador Petroleum Corp. | CS70-9 | | |

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## Small Producer Certificates, April 30, 1971—Continued

| Seller | Docket | Order granting CS Cert.* | Other |
|---|---|---|---|
| Grynberg, Jack J. & Celeste C. | CS71-320 | | |
| Guffey, A. A. | CS69-91 | 09-16-69 | |
| Gulf Minerals Incorporated | CS71-298 | | |
| Gut, Rainer E. | CS69-51 | 07-25-69 | |
| Haferkamp, A. O. | CS71-286 | | |
| Harford, John A. | CS71-172 | | |
| Hale, Elwyn C. & Mabel E. | CS66-97 | 08-29-66 | |
| Hamilton Brothers Pet. Corp. | CS71-77 | | |
| Hamm, Richard B. | CS69-88 | 06-04-69 | |
| Hammonds, G. Scott | CS66-74 | 07-20-66 | |
| Hansen, Jake L. | CS66-107 | 07-13-66 | |
| Hanley Company | CS70-48 | 09-22-70 | |
| Hanson Oil Corporation | CS71-20 | 12-11-70 | |
| Hardey, C. O., Oper. | CS71-282 | | |
| Harkins & Company | CS71-248 | | |
| Harkins, E. T. | CS67-22 | 01-24-67 | |
| Harlow, W. V. | CS71-114 | | |
| Harris, John M. | CS69-65 | 09-16-69 | |
| Harris, R. C. | CS-71325 | | |
| Harrison, Dan J., Jr. (I) | CS-71545 | | |
| Harrison Oil Company (II) | | | |
| Harrison, D. J. | CS71-525 | | |
| Hart, Patricia Ruth Carter | CS68-33 | 12-15-67 | |
| Hartman, W. L. | CS71-14 | 02-05-71 | |
| Hawley, J. M. | CS71-33 | | |
| Hawthorne, Hugh A. | CS71-236 | | |
| Haynes, Charles A. | CS69-9 | 12-03-68 | |
| Haynie-Mayer | CS71-225 | | |
| Heath, Mary Horne (Now Horne, Mary Madeline) | CS68-3 | 09-27-67 | Name Change 09-10-70 |
| Heldt, James D. | CS71-345 | | |
| Helmly & Prather Oil Co. | CS71-375 | | |
| Henderson, J. Harry, Jr. | CS71-453 | | |
| Hendrix, John H. | CS69-13 | 12-16-68 | |
| Herd, J. H. | CS68-42 | 04-16-68 | |
| Hernstadt, William L. Estate of Deceased (Now Fishman, Felix A.) | CS66-9 | 05-11-66 | Name Change 11-23-70 |
| Herrmann, A. E., Corp. | CS71-234 | | |
| Hicks Durham, Inc. | CS71-401 | | |
| Hicks, Robert F. | CS67-23 | 01-24-67 | |
| Highland Production Company | CS70-30 | 02-10-70 | |
| Hill, John H. | CS71-68 | | |
| Hills, F. N. Production | CS71-370 | | |
| Hines and Hobbs | CS71-368 | | |
| Hines, Johnny E. | CS71-372 | | |
| Hines, Johnny E., et al. | CS71-371 | | |
| Hirsch, William B. | CS71-498 | | |
| Hissom Drilling Company | CS69-98 | 09-16-69 | |
| Hodge, Floyd M. | CS71-330 | | |
| Hodges, A. J. Industries Inc. | CS71-433 | | |
| Holder, Horace M. | CS71-306 | | |
| Holt Brothers | CS71-229 | | |
| Holt, O. C. | CS71-180 | | |
| Holton, Walter B. | CS69-61 | 06-12-69 | |
| Honeyman, Robert B., Jr. | CS66-25 | 07-20-66 | |
| Horne, May Madeline (Formerly Heath, Mary Horne) | CS68-3 | 09-27-67 | |

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## *Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Horner, Richard R. | CS71-532 | | |
| Houston Oil & Minerals Corporation | CS71-453 | | |
| Howard, Frank A. Estate of | CS68-18 | 11-20-67 | |
| Huber, Fred Trustee | CS69-69 | 09-16-69 | |
| Hudson, Edward R. Jr. & | CS67-32 | 03-13-67 | |
| Hudson, William A., II | | | |
| Hudson, William A. and Edward R. | CS69-5 | | Returned 11-08-68 |
| " " " | CS71-260 | | |
| Humphrey, Joe A. | CS71-111 | | |
| Hunter, J. D., Trustee | CS67-81 | 07-28-67 | |
| Husky Oil Company of Delaware (Formerly Husky Oil Company) | CS66-33 | 06-14-66 | |
| Husky Oil Company of Delaware | CS71-47 | | |
| Hut, Less d/b/a | CS71-247 | | |
| H and J Drilling Co. | | | |
| Imperial-American Management Company | CS69-58 | 07-25-69 | |
| Inexco Oil Company | CS71-254 | | |
| Inman, Curtis R. | CS66-60 | 07-20-66 | |
| Inv stors Petroleum Corporation | CS67-35 | 06-26-67 | |
| J. M. Well Service, Inc. | CS71-405 | | |
| Jackman, David Jr. and Armstrong, Robert C. | CS71-145 | | |
| Jackson, Donald W. | CS71-177 | | |
| English Jackson, Inc. | CS67-14 | 11-14-66 | |
| Jeffries, Bradley and Body | CS71-249 | | |
| Jenkins, Stewart R., Jr. | CS71-306 | | |
| Jenkins, T. D. | CS69-78 | 09-16-69 | |
| Jenkins, Winston | CS71-441 | | |
| Jet Oil Company | CS71-391 | | |
| Johnson & French Oil Company | CS66-24 | 07-20-66 | |
| Jones, Edwin M. Oil Co. | CS71-364 | | |
| Jones, L. E. Production Company, et al. | CS71-509 | | |
| Jones & Pellow Oil Company | CS71-157 | | |
| Judd, Michael T. | CS71-496 | | |
| Kadane, G. E. & Sons | CS71-287 | | |
| Kaiser, Herman Geo. | CS71-179 | | |
| Kalvin, Nathan | CS71-477 | | |
| Kansas Petroleum, Inc. | CS71-164 | | |
| Kasper, Alexander G. | CS67-100 | 07-28-67 | |
| Keating-Parker Drilling Co. | CS71-286 | | |
| Kenmore Oil Company, Inc. | CS71-472 | | |
| Kenworthy, Paul W. | CS71-209 | | |
| Kenyon, Clarence | CS71-292 | | |
| Kerbs, Jeanne E. | CS67-96 | 07-21-67 | |
| Kermit Oil Company | CS67-6 | 11-14-66 | |
| Kestler, C. M. | CS69-60 | 09-16-69 | |
| Kewanee Oil Company | CS66-12 | 07-20-66 | |
| Kibo Compressor Corporation | CS70-29 | 02-10-70 | |
| Kimball, Alberta S. | CS66-87 | 07-20-66 | |
| Kimberlin & Dunn | CS71-185 | | |
| Kimsey, Roy E., Jr. | CS66-66 | 07-20-66 | |
| King, Beverly Ann Laskey | CS71-415 | | |
| King, Robert E. | CS71-342 | | |
| King, Warren Dye | CS67-90 | 07-28-67 | |
| Kingwood Oil Company | CS71-41 | | |
| Kinne, M. L. | CS71-507 | | |
| Krikpatrick Oil and Gas Co. | CS71-42 | | |
| Kluthe, Joseph G. | CS69-30 | 03-20-69 | |

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*Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Knight, Lester T. | CS71-489 | | |
| Kornbluh, Jay | CS71-352 | | |
| L & B Oil Gas Company | CS71-181 | | |
| L & N Production Company | CS67-46 | 03-13-67 | |
| Lacy, James W. | CS69-62 | 08-13-69 | |
| Ladenburg, Thalmann & Company | CS67-86 | 07-28-67 | |
| LaForce, W. Watson | CS66-102 | 06-14-66 | |
| Lamb, James L., Jr. | CS68-36 | 12-12-67 | |
| Lament, Thomas S. | CS66-19 | | Dismissed 11-20-67 |
| Landmark Oil, Inc. | CS66-125 | 08-11-66 | |
| Lange, R. W. | CS71-232 | | |
| Langham, J. T. | CS66-56 | 04-08-66 | |
| Lanier, Cecil L. | CS71-27 | | |
| Lanier, Sidney | CS66-42 | 04-08-66 | |
| Larsen, Perry E. | CS71-379 | | |
| LaRue, C. E. & Muncy, B. N., Jr. | CS69-24 | 02-24-69 | |
| Lastoy, Linna Marie | CS71-416 | | |
| Latch, Leonard | CS67-3 | 09-27-66 | |
| Laria Oil & Gas Company | CS70-35 | | Returned 02-19-70 |
| Late Oil Company | CS67-60 | 06-22-67 | |
| D. R. Lauck Oil Company, Inc. | CS71-166 | | |
| Lawson, D. J. | CS69-65 | 09-16-69 | |
| Lear Petroleum Corporation | CS71-26 | | |
| Leede, Edward H. | CS66-39 | 04-08-66 | |
| Leben Drilling, Inc. | CS71-56 | 02-17-71 | |
| Lechner and Hubbard | CS71-392 | | |
| Leforce, Paul K. & E. H. Klein | CS71-357 | | |
| Lehrs, Petroleum Company, Inc. | CS71-212 | | |
| Lemmons, Blanche | CS68-50 | 06-05-68 | |
| Leonard, J. M. | CS68-23 | 02-28-68 | |
| Leonard Oil Company | CS66-20 | | Withdrawn 11-23-66 |
| Lesh Company | CS67-28 | 03-13-67 | |
| Lewis, J. Kent | CS71-497 | | |
| Leyhe, Edward F. | CS66-86 | 07-20-66 | |
| Livermore, George P. | CS67-87 | 07-28-67 | |
| Loftis, J. Stewart, Dr. | CS69-101 | 09-16-69 | |
| Logue & Patterson | CS71-367 | | |
| Lone Star Explorations, Inc. | CS71-64 | | |
| Long, C. E. | CS69-27 | 02-24-69 | |
| Longhorn Service & Drilling Co; | CS71-419 | | |
| Losita, Inc. | CS71-61 | | |
| Lowe, Ralph, Estate of | CS70-15 | 10-15-69 | |
| Lundbeck, G. Hilmer, Jr. | CS68-20 | 11-20-67 | |
| Lundelis, Inc. OKA | CS71-298 | | |
| Lyle, W. M., Estate of, Scott B. Appleby, W. O. Anderson and Demova K. Frost | CS68-5 | | |
| Lynch, Jess d/b/a Savage Oil Co. | CS67-27 | 01-24-67 | |
| Lyons, C. H., Sr. | CS71-523 | | |
| Lyons, Richard T. | CS66-112 | 06-24-66 | |
| M and B Well Service | CS66-117 | 06-07-66 | |
| MEB Oil Company (Now Bourg, Oscar, Estate of) | CS68-5 | 08-28-67 | Name Change 03-31-70 |
| MKA Oil Properties | CS69-39 | 06-04-69 | |
| MWJ Producing Company | CS69-66 | 07-25-69 | |
| McAlester Fuel Company | CS67-77 | 07-07-67 | |
| McBride, W. C., Inc. | CS71-542 | | |

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## Small Producer Certificates, April 30, 1971—Continued

| Seller | Docket | Order Issuing CS Cert.* | Other |
|---|---|---|---|
| McCall, Jack O | CS67-17 | 11-14-66 | |
| McCammon, J. H. | CS71-8 | 09-10-70 | |
| McCarty, T. A. | CS71-329 | | |
| McCarty, W. A. and Hazlewood, John | CS71-151 | | |
| McClain, O. G. | CS71-279 | | |
| McCombs, Barbara B. | CS67-56 | 05-04-67 | |
| McCommons Oil Company OEA | CS71-288 | | |
| McCutchin, Alma (Operator) | CS71-480 | | |
| McCutchin, Benjamin C. (Self) | CS71-480 | | |
| McCutchin, Gene (Self) | CS71-459 | | |
| McCutchin, Jerry (Self) | CS71-479 | | |
| McCutchin, Ronald Lee (Self) | CS71-481 | | |
| MacDonald, Burns & Norris #2 | CS71-451 | | |
| MacDonald Oil Corporation | CS70-10 | 10-15-69 | |
| McFarlin, R. B. & Ketchum, E. P. | CS68-140 | 09-07-68 | |
| McGrath & Smith (Now Cequiea Oil Corporation). | CS66-101 | 07-20-66 | Succession 3-18-71 |
| McKnight, Byron | CS71-48 | 01-18-71 | |
| McMillan, J. G. | CS70-45 | 07-07-70 | |
| McMoran Exploration Co. | CS71-331 | | |
| Mabee, Joe | CS67-58 | 05-09-67 | |
| Mack Oil Company | CS71-184 | | |
| Maguire Oil Company | CS71-122 | | |
| Major, Giebel & Forster | CS69-81 | 08-20-69 | |
| Mallard Exploration, Inc. | CS71-335 | | |
| Mallonee-Mahoney, Inc., Mahoney Drilling Company, T. W. Mahoney | CS71-444 | | |
| Mana Resources, Inc. | CS71-17 | 09-17-71 | |
| Manler Oil Company | CS71-208 | | |
| Markham, Cone & Redfern | CS66-70 | 07-20-66 | |
| Markham, Jack | CS67-79 | 07-28-67 | |
| Markim Corporation | CS71-12 | 11-23-70 | |
| Marrow, N. S. | CS67-19 | 11-14-66 | |
| Marlow Oil Company | CS71-126 | | |
| Marshall, William Bartlett | CS71-180 | | |
| Marshall & Winston, Inc. | CS71-374 | | |
| Maxwell Oil Company | CS66-2 | 07-20-66 | |
| May, John L. | CS66-90 | 06-14-66 | |
| May Petroleum Inc. | CS71-42 | | |
| Maynard Oil Company | CS71-282 | | |
| Medco Properties Ltd. (Now Bill C. Cotner d/b/a Medco Properties) | CS67-18 | 11-14-66 | Name Change 04-13-70 |
| Meeker & Company | CS69-47 | | Returned 06-12-69 |
| Meeker, J. J. | CS69-55 | 07-25-69 | |
| Meeker, L. H. | CS69-54 | 07-25-69 | |
| Meeker, W. W. | CS67-43 | 06-13-67 | Terminated 7-28-69 |
| Meeker, William Wade Estate of | CS69-48 | 07-25-69 | |
| Melbourne Corporation | CS69-79 | 09-16-69 | |
| Melton, M. L. | CS70-25 | 02-02-70 | |
| Mercantile National Bank at Dallas Trustee of the L. L. Horne Testamentary Trust (Consolidated with CS66-3 Mary Horne Heath) | CS66-2 | 09-01-67 | Returned 09-01-67 |
| Merrion, J. Gregory | CS71-448 | | |
| Mesa Petroleum Co., et al. (Formerly Petroleum Exploration, Inc. of Texas) | CS67-83 | 12-21-67 | |
| Messman-Rinehart Oil Company | CS71-160 | | |
| Me-Tex Supply Company | CS66-123 | 06-07-66 | |

See footnote on p. 65a.

## Small Producer Certificates, April 30, 1971—Continued

| Seller | Docket | Order Issuing CS Cert.* | Other |
|---|---|---|---|
| Metropolitan Oil Corporation | CS71-239 | | |
| Meyers, S. G., Jr., et al. | CS71-547 | | |
| Miami Oil Producers, Inc. | CS71-261 | | |
| Midhurst Oil Corporation | CS68-122 | 05-20-68 | |
| " " " | CS67-9 | | Cancelled 12-30-69 |
| Midland National Bank, Trustee | CS69-40 | 08-20-69 | |
| Midstates Gas Transportation Co. | CS71-535 | | |
| Midwest Oil Corporation | CS68-97 | | Rejected 04-01-69 |
| Miles Kimball Company | CS66-85 | 07-20-66 | |
| Mills, F. H. Jr. | CS71-208 | | |
| Minco Oil & Gas Company | CS71-280 | | |
| Minter, Nora Lasky | CS71-440 | | |
| Mitchell & Lewis | CS71-514 | | |
| M. J. Mitchell | CS71-238 | | |
| Mitchell Oil Company | CS71-199 | | |
| Moberly, George A. | CS67-72 | 06-22-67 | |
| Moncrief, W. A. | CS67-10 | | Withdrawn 09-29-67 |
| Moncrief, W. A. | CS67-98 | 07-28-67 | |
| Monroe, Eugene R. | CS71-153 | | |
| Montin, William V. | CS71-475 | | |
| Moore, J. Hiram | CS66-110 | 06-14-66 | |
| Moore, Kenneth B. | CS71-118 | | |
| Moore, Samuel H. | CS69-82 | 09-16-69 | |
| Moorhead, Ethyle | CS71-312 | | |
| Moran, R. M. | CS71-131 | 02-05-71 | |
| Morgan Petroleum Company | CS71-305 | | |
| Morris, Ann W. | CS66-14 | 12-16-66 | |
| Morrison, Graham B. and York, O. C. | CS71-298 | | |
| Moses, Henry & Lucy Foundation Trust | CS66-7 | 05-11-66 | |
| Moses, Lucy G. | CS66-6 | 05-11-66 | |
| Moss, Joseph F. | CS71-425 | | |
| Mountain States Petroleum Corporation | CS71-16 | 12-11-70 | |
| Moursund, A. W. | CS71-67 | | |
| Mueller, Joseph P. | CS71-289 | | |
| Mull Drilling Co., Inc. | CS71-60 | | |
| Mull, J. A., Jr. | CS71-72 | | |
| Muse, Albert C. | CS66-133 | 08-11-66 | |
| Nabob Production Company | CS71-115 | | |
| Nassau Oil & Gas Corporation | CS67-61 | 06-22-67 | |
| National Bank of Tulsa, Executor of the Estate of James A. Chapman, Deceased | CS69-28 | 04-15-69 | |
| National Cooperative Refinery Association | CS69-32 | 04-15-69 | |
| National Exploration Company | CS71-454 | | |
| Neich Gas & Oil Corporation | CS66-127 | 07-20-66 | Terminated 04-17-70 |
| Ne-O-Tex Corporation | CS67-15 | 12-20-66 | |
| Newmont Oil Company | CS71-510 | | |
| Newton, Donna Elizabeth Laskey | CS71-417 | | |
| Nichols, Don R. | CS71-338 | | |
| Nichols, L. B., Jr. | CS71-348 | | |
| Ni-Gas Supply, Inc. | CS69-29 | 04-15-69 | |
| Nilsen, Carl A. | CS71-278 | | |
| Nolan, William C. & Theodosia M. d/b/a Munoco Company | CS67-75 | 06-07-67 | |
| Nomac Oil Company, Inc. | CS71-225 | | |
| Norman, D. M. | CS66-51 | 06-05-66 | |
| North American Royalties, Inc. | CS71-152 | | |
| North Central Oil Corporation | CS67-8 | 12-20-66 | |

* See footnote on p. 65a.

## *Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| North Star Petroleum Corp. | CS71-198 | | |
| Northern Pump Company | CS71-22 | 03-18-71 | |
| Norwood Oil Company and/or Norwood Drilling Company | CS68-26 | 12-15-67 | |
| The Nowery Corp. | CS71-300 | | |
| The Nueces Company | CS66-116 | | Withdrawn 04-28-66 |
| Nutt, T. L. | CS71-140 | | |
| O F & R Oil Company | CS67-48 | 05-31-67 | |
| O'Banion, Robert | CS71-499 | | |
| O'Briant, James F. | CS69-97 | 09-16-69 | |
| O'Brien Company | CS71 116 | | |
| O'Doyle, John W. | CS71-346 | | |
| O'Meara, Robert W. | CS71-492 | | |
| O'Neill, Joseph L., Jr. | CS67-108 | | Dismissed 11-20-67 |
| O'Neill, Joseph L., Jr. | CS68-21 | 11-20-67 | |
| O'Quinn, Frances M. | CS71-408 | | |
| Oakland Corporation | CS71-355 | | |
| Oehlschager, F. Keith, Dr. | CS70-33 | 08-31-70 | |
| The Ohio Fuel Supply Company | CS71-427 | | |
| Oil Finders, Inc. | CS71-403 | | |
| Oil & Gas Futures, Inc. | CS71-432 | | |
| Oil Properties, Inc. | CS71-237 | | |
| Oil Well Drilling Company | CS66-41 | 07-20-66 | Terminated |
| Olsen, Howard | CS67-44 | 03-13-67 | |
| Oringderff, Alma | CS71-267 | | |
| Ormand Industries, Inc. (Formerly Ryan Consolidated Petroleum Corp.) | CS66-137 | 08-11-66 | |
| Osborn, W. B., Jr. | CS71-126 | | |
| Outline Oil Corporation | CS71-275 | | |
| Owen, A. | CS70-18 | 11-10-69 | |
| Owen, Robert L. | CS70-23 | 12-03-69 | |
| Ozark-Mahoning Company | CS71-68 | | |
| Palmer, J. T. | CS71-554 | | |
| Panhandle Producing Company | CS71-44 | | |
| Parker & Parsley | CS67-25 | 07-28-67 | |
| Parkes, Frank | CS71-110 | | |
| Patoil Corporation | CS71-402 | | |
| Patrick, Rolland J. | CS71-174 | | |
| Paul, C. M., Colonel | CS69-86 | 09-16-69 | |
| Payne, Clifford E. | CS67-86 | 07-28-67 | |
| Peerless Incorporated | CS71-90 | | |
| Peet, Edwin J., Trustee Assignee of Johnnye Jones Peet, d/b/a Peet Oil Company | CS71-428 | | |
| Penner, Ted | CS69-53 | 07-25-69 | |
| Penrose, Neville G. | CS66-53 | 06-14-66 | |
| Penrose Production Company | CS66-56 | 06-14-66 | |
| Penton & Penton | CS69-15 | | Withdrawn 07-28-69 |
| " " | CS71-430 | | |
| Perritt, H. W. | CS71-476 | | |
| Peterson, French | CS70-4 | 09-16-69 | |
| Petroleum Corporation | CS71-315 | | |
| Petroleum Corporation of Texas | CS70-37 | 06-08-70 | |
| Petroleum Exploration, Inc. of Texas (Now Moss Petroleum Co.) | CS67-63 | 07-07-67 | Succeeded to by Moss 12-21-67 |
| Petro-Search Inc., et al. | CS71-515 | | |
| Pevehouse, B. J. | CS69-72 | 09-16-69 | |
| Pharaon, Richard, Dr. | CS69-99 | | Withdrawn 09-16-69 |

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*Small Producer Certificates, April 30, 1971*—**Continued**

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Pelham Development Co. | CS71-82 | | |
| Phillips, H. H. | CS71-318 | | |
| Pickens, W. C. | CS71-309 | | |
| Pitman, John Douglas | CS71-168 | | |
| Plummer, Paul E., Jr., Agent for Paul E. Plummer, et al. | CS71-238 | | |
| Pogue, A. W. | CS71-527 | | |
| Polk, Louis | CS67-40 | 03-13-67 | |
| Pool and Hooper Oil Properties | CS71-310 | | |
| Powell, C. A. and Stone, D. J. d/b/a Powell & Stone | CS71-221 | | |
| Powell, Celestine V. Trust | CS66-69 | 06-14-66 | |
| Prairie Producing Company | CS71-421 | | |
| Premlite Corporation OEA | CS71-465 | | |
| Prichance Oil & Gas, Inc. | CS71-183 | | |
| Producers Gas Company | CS71-25 | | |
| Propps, E. D. | CS71-224 | | |
| Prudential Minerals Exploration Corporation | CS71-203 | | |
| Puckett, L. H. | CS71-88 | | |
| Pursley, C. P. | CS71-244 | | |
| Pursley, C. P. and Pursley, Erwin | CS71-245 | | |
| Pursley, C. P., Erwin Pursley and Jim Cornutt | CS71-246 | | |
| RPL Oil Company, Inc. | CS69-41 | 08-04-69 | |
| Rains, Emmett J. | CS71-524 | | |
| Ramsey, Roy H. and Clyde M. Gassaway d/b/a Ramsey & Gassaway Oil & Gas Properties | CS71-21 | 03-05-71 | |
| Rasmussen, James W. | CS69-16 | 12-16-68 | |
| Ray, Bernard A. | CS67-57 | 05-04-67 | |
| Read & Stevens, Inc. | CS70-42 | 07-07-70 | |
| Reed, Thomas A. | CS69-63 | 09-16-69 | |
| Reading & Bates, Inc. | CS71-522 | | |
| Redfern Development Corporation | CS67-67 | 07-24-67 | |
| Redfern Oil Company | CS67-66 | 07-20-67 | |
| Regester, H. W. | CS66-125 | 08-11-66 | Terminated 03-10-70 |
| Reigle, E. E. d/b/a Richmond Dilling Company | CS66-64 | 07-20-66 | |
| Reinschmidt, Christie T. | CS71-487 | | |
| Reliance Development Corporation | CS71-113 | | |
| Rennig Oil Company | CS71-149 | | |
| Reserve Oil & Gas Company | CS66-72 | 07-20-66 | |
| Rexler & Sheldon | CS66-26 | 06-14-66 | |
| " " | CS71-307 | | |
| Rezzonico, Louis A., Dr., Estate of and Rezzonico, Louis A., Jr., Executor | CS70-16 | 11-19-69 | |
| Rice, Ruth C. | CS71-57 | | |
| Richesne Oil & Gas Company | CS71-65 | | |
| Rilan Corporation | CS66-134 | 08-11-66 | |
| Rimrock Exploration Company, Inc. | CS71-29 | | |
| Ritchie, A. S., et al. | CS71-208 | | |
| Ritchie, M. H. W. | CS68-54 | 10-14-68 | |
| Roath, C. Henry | CS71-544 | | |
| Roberts, Fred | CS71-311 | | |
| Roberts and Whitsun Petroleum Inc. | CS71-250 | | |
| Robertson, French M. | CS66-67 | 04-22-66 | |
| Robinson, L. L. | CS71-205 | | |
| Roden Oil Company | CS69-33 | 04-15-69 | |
| Rodman, E. G. | CS66-80 | 11-07-66 | |
| Rodman, E. G. OEA | CS66-81 | 11-07-66 | Terminated 05-22-70 |

*See footnote on p. 65a.

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*Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing Oil Cert.** | *Other* |
|---|---|---|---|
| Rodman & Lale (see Thornton Petroleum Corp. & Lale, et al.) | CS68-48 | 11-07-68 | Terminated 6-22-70 |
| Rodman Oil Company (see Thornton Oil Company) | CS69-49 | 11-07-68 | Terminated 06-22-70 |
| Rodman Petroleum Corporation (see Thornton Petroleum Corporation) | CS69-52 | 11-07-68 | Terminated 06-22-70 |
| Rogers, M. D. | CS69-70 | 09-16-69 | |
| Rollings, Harry E., Dr. | CS69-67 | 09-16-69 | |
| Rosenthal, Jerome B. | CS67-70 | 08-23-67 | |
| Ross, Walter M. | CS69-66 | 09-16-69 | |
| Rucker, H. J. | CS71-66 | 01-18-71 | |
| Rudman, M. B. | CS67-4 | 11-14-66 | |
| Rudman Resources, Inc. | CS71-175 | 02-17-71 | |
| Rushmore, Robert T. | CS71-463 | | |
| Russell, Jack L. | CS68-111 | 06-24-68 | |
| Russell, Jane Clayton | CS71-34 | | |
| Rutherford, P. R. | CS67-97 | 07-28-67 | |
| Rutter and Company Ltd. | CS70-38 | 07-31-70 | |
| Rutter, A. W. | CS70-46 | 07-31-70 | |
| Rutter, A. W., Jr. | CS70-40 | 07-31-70 | |
| Rutter & Wilbanks Brothers | CS67-84 | 07-07-67 | |
| Ryan Consolidated Petroleum Corp. (Now Ormand Industries) | CS66-127 | 08-11-66 | Name Change 06-07-70 |
| S & G Oil Company, Inc. | CS71-431 | | |
| Sabine Oil Industries Inc. | CS71-195 | | |
| Sage Petroleum Company | CS71-200 | | |
| Samedan Oil Corporation | CS71-420 | | |
| Sams Oil Corporation | CS69-44 | 07-25-69 | |
| Sandlin, Walter P., Receiver | CS70-35 | 02-02-70 | Terminated 07-07-70 |
| Saunders, Howard F. | CS71-104 | | |
| Schaefer, Nicholas J. | CS71-546 | | |
| Schimmel Oil Co. | CS71-302 | | |
| M & G and Schneider Oil Company | CS66-104 | 05-24-66 | |
| Schneider, Tom | CS70-19 | 11-10-69 | |
| Scott, Chas. W., et al. | CS71-187 | | |
| Searle, John G. | CS67-42 | 03-13-67 | |
| Seewald, Hughes | CS71-78 | | |
| Semple, C. A. | CS69-71 | 09-16-69 | |
| Semple, Charles O. | CS69-68 | 09-16-69 | |
| Service Drilling Co. | CS71-144 | | |
| Shaffer, Milton F. OKA | CS71-326 | | |
| The Shallow Water Refining Co. | CS71-235 | | |
| Sharples & Company Properties | CS66-21 | 03-25-66 | |
| " " " | CS71-60 | | |
| Shea, Edward L., Estate of | CS68-22 | 11-30-67 | |
| Shea, Peter L. | CS68-23 | 11-30-67 | |
| Shenandoah Oil Corporation | CS71-364 | | |
| Sherrill, Virginia | CS71-100 | 02-08-71 | |
| Sherrod, Clifford H., Jr. | CS71-182 | | |
| Shettle, George O. | CS71-238 | | |
| Shield, Fred W. | CS71-469 | | |
| Sidwell, E. C. | CS71-125 | | |
| Sidwell Oil and Gas, Inc. | CS71-124 | | |
| Sigma Exploration Corporation | CS71-143 | | |
| Simmons, Jay | CS68-37 | 12-18-67 | |
| Singer-Fleischaker Oil Company | CS71-343 | | |
| Slade, Inc. | CS66-23 | 04-05-66 | Terminated 05-20-70 |

* See footnote on p. 65a.

*Small Producer Certificates, April 30, 1971—Continued*

| Seller | Docket | Order Issuing CS Cert.* | Other |
|---|---|---|---|
| Sloan, M. L. a/k/a Marion L. Sloan and Marie R. Sloan | CS71-120 | | |
| Smith, Earl T. and Associates, Inc. | CS71-31 | | |
| Smith & Gribble | CS71-[illegible] | | |
| Smith, Marie Watkins (Mrs.) | CS71-651 | | |
| Smith, W. H. Construction Company | CS71-224 | | |
| Smyth, Earl W. | CS69-96 | 09-16-69 | |
| Snead, Charles B. | CS71-485 | | |
| Snead, William S., Estate of | CS71-490 | | |
| Snow, D. R. | CS71-494 | | |
| Snyder, A. Walter, Agent for Betty Gutting | CS69-37 | 06-04-69 | |
| Soderstrom, Glen S. | CS71-48 | | |
| Solar Oil Company | CS69-67 | 07-25-69 | |
| Somerville, J. Keith | CS71-193 | 03-18-71 | |
| South States Oil and Gas Company | CS71-305 | | |
| Southern Minerals Corporation | CS66-39 | 03-21-66 | Terminated 08-16-66 |
| Southern Petroleum Exploration, Inc. | CS66-47 | 04-08-66 | |
| Southland Royalty Company | CS66-114 | 07-29-66 | |
| Southwest Oil Industries, Inc. | CS71-195 | | |
| Southwestern Exploration Consultants, Inc. | CS71-394 | | |
| Southwestern-Greer Estate No. 1 Limited | CS66-65 | 07-29-66 | |
| Southwestern Natural Gas, Inc. | CS66-127 | 08-11-66 | |
| Speight, June D. | CS68-29 | 11-09-67 | |
| Spence, Aurelia | CS66-105 | 06-14-66 | |
| Spradling, L. R. and/or Spradling Drilling Company | CS71-191 | | |
| Stanley, Larry | CS69-92 | 09-16-69 | |
| Staples, James W. | CS69-21 | Cancelled.. See CI69-742 | |
| State Exploration Company and Statex Petroleum | CS71-534 | | |
| Steed, S. D. | CS69-65 | 09-16-69 | |
| Stencel, R. | CS71-88 | | |
| Stewart, Edmond L., Trust | CS71-304 | | |
| Stewart Oil & Gas, Inc. | CS71-508 | | |
| Stockard, W. A., et al. | CS71-442 | | |
| Stoltz, Deane H. | CS69-22 | 02-10-69 | |
| Stoneham, Jack J. | CS70-2 | 09-16-69 | |
| Strahan Oil & Gas Company, Inc. For Itself and as Operator for Non-Signatory Co-Owners, James W. Adcock and W. J. Wegman, Jr. | CS71-436 | | |
| Strait, F. W., Inc. | CS71-471 | | |
| Stringer, J. Frank | CS68-36 | 02-01-68 | |
| Success Oil & Gas Company, Inc. | CS71-512 | | |
| Summit Energy Inc. (Formerly Western Oil Fields, Inc.) | CS71-414 | | |
| Sunset International Petroleum Corporation | CS70-14 | 10-15-69 | |
| Sunshine Royalty Company | CS67-80 | 07-28-67 | Terminated 03-25 71 |
| Swift-Sterne Corporation | CS71-255 | | |
| Tate & Gribble | CS71-449 | | |
| Taylor, Jack G. | CS71-424 | | |
| Taylor, Vernon Jr. | CS71-89 | | |
| Taylor, W. H., Estates | CS71-65 | | |
| Tesoro Petroleum Corp. | CS71-340 | | |
| Tewksbury, Baird | CS71-498 | | |
| Texam Oil Corporation | CS66-108 | 07-20-66 | |
| Texam Oil Company | CS71-482 | | |
| Texas American Oil Corporation | CS67-36 | 08-13-67 | |

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***Small Producer Certificates, April 30, 1971*—Continued**

| *Seller* | *Docket* | *Order Issuing CS Ctrl.** | *Other* |
|---|---|---|---|
| Texas City Refining, Inc. | CS70-13 | 10-08-69 | |
| Texas Crude, Inc. | CS71-299 | | |
| Texas Crude Oil Company | CS69-46 | 07-25-69 | |
| Texas Crude Oil, Inc. | CS71-290 | | |
| Texas Gulf Sulphur Corporation | CS71-383 | | |
| Texstar Exploration, Inc. | CS71-30 | | |
| Thagard, George F., Jr. | CS71-1 | 09-10-70 | |
| Thagrad, George F., Jr., Trustee | CS71-2 | 09-10-70 | |
| Thalman, E. H. | CS71-330 | | |
| Thomas, Clifton | CS70-34 | 08-31-70 | |
| Thomas, Evan A. | CS71-439 | | |
| Thomas, Max L. | CS71-434 | | |
| Thompson & Cone | CS66-47 | 07-20-66 | |
| Thompson, Craft | CS70-12 | 10-15-69 | |
| Thompson, J. Cleo | CS67-24 | 01-24-67 | |
| Thompson Operating Company | CS71-94 | | |
| Thompson, Roy | CS71-409 | | |
| Thornton Oil Company (Formerly Rodman Oil Company). | CS66-49 | 11-07-66 | Terminated 06-22-70 |
| Thornton Petroleum Corporation (Formerly Rodman Petroleum Corporation). | CS66-62 | 11-07-66 | Terminated 06-22-70 |
| Thronton Petroleum Corporation and Late (Formerly Rodman and Late). | CS66-48 | 11-07-66 | Terminated 06-22-70 |
| Thornton, Risher M. III | CS69-100 | 09-16-69 | |
| Throckmorton, R. E. | CS71-328 | | |
| Tipperary Resources Corporation | CS71-11 | 12-21-70 | |
| Todd, W. L., Jr. | CS66-16 | 06-14-66 | |
| Trace, Inc. | CS69-1 | 09-03-68 | |
| Tresner, Gerald T. | CS71-464 | | |
| Triangle J. Oil Company | CS71-376 | | |
| Tribune Oil Corporation | CS69-26 | 06-30-69 | |
| Trident Corporation | CS71-521 | | |
| Trident Oil & Gas Corporation | CS71-513 | | |
| Triple S Oil Company | CS71-321 | | |
| Tri-Service Drilling Company | CS67-37 | 03-13-67 | |
| Trumart Oil Company | CS71-211 | | |
| Tucker, R. C. | CS67-62 | 07-24-67 | |
| Tucker Drilling Company, Inc. | CS66-3 | 07-20-66 | |
| Turner, Fred, Jr. | CS67-96 | 07-29-67 | |
| Turner, J. S. | CS71-381 | | |
| Two States Oil Company | CS68-35 | 12-29-67 | |
| Tyra & Tyra | CS69-20 | 01-21-69 | |
| Tyrrell, W. C., Jr., (Formerly Tyrrell, W. C., Trust) | CS67-21 | 07-28-67 | |
| Underwood, Rip C. | CS71-46 | | |
| Union National Bank of Wichita, Executor of the Estate of Walter F. Kuhn, Deceased | CS71-158 | | |
| U.S. Natural Resources Inc. | CS71-276 | | |
| U.S. Smelting, Refining & Mining Company | CS67-86 | 07-07-67 | |
| Unmm, Incorporated | CS70-50 | 09-21-70 | |
| Valley Investment Corporation | CS69-63 | 09-16-69 | |
| Vaughn, G. H., Jr. and Vaughn, Jack C. | CS66-14 | 06-14-66 | |
| Vaughn Petroleum Inc. (For Itself & As Agent) | CS71-552 | | |
| Venus Oil Co. | CS71-202 | | |
| Vest, Earl d/b/a Vest, Dorbandt & Ross | CS66-120 | 08-11-66 | |
| Viersen and Cockran | CS71-65 | | |
| Viersen, Sam J. | CS71-64 | | |

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*Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Viersen, Sam K., Jr. | CS71-83 | | |
| Vinson, M. C. | CS69-45 | 07-28-69 | |
| Veer Mac, Trust | CS71-381 | | |
| Wager, Dan R. & Diane Oil Co. | CS71-437 | | |
| Wakefield, Jean Bristol | CS71-474 | | |
| Walkup, Bruce | CS66-128 | 08-15-66 | |
| Wallace, Robert R, | CS68-46 | 04-18-68 | |
| Wallen Production Company | CS67-104 | 08-30-67 | |
| Walters, Carl E. | CS69-7 | | Rejected 10-09-68 |
| Warren, Curtis | CS66-4 | 06-28-67 | |
| Warren, Darrell S. | CS66-109 | 08-15-66 | |
| Warren, Guy L. | CS71-365 | | |
| Watts, Ed. E. | CS66-43 | 04-08-66 | |
| Way, Ralph L. | CS71-257 | | |
| Weaver, Shirley H., Trust | CS66-94 | 04-22-66 | |
| Weaver, W. Carlton | CS71-517 | | |
| Weaver, W. R. | CS66-93 | 04-22-66 | |
| Webb, Del E. | CS68-30 | 01-22-68 | |
| Webber, Jack, et al. | CS71-536 | | |
| Weber, Frederick Palmer | CS69-84 | 09-16-69 | |
| Weier, A. D., Jr. | CS66-25 | 06-14-66 | |
| Welborn, J. M. | CS67-78 | 07-28-67 | |
| Welori Lumber Company | CS71-508 | | |
| Weltman, Louis H., et al. | CS71-531 | | |
| Werner, Ronald L. | CS71-297 | | |
| Wessely, Arthur J. | CS71-83 | | |
| Wessely Petroleum, Ltd. | CS71-75 | | |
| Westates Petroleum Company | CS66-115 | 07-20-66 | |
| Westbrook, V. H. | CS71-154 | | |
| Westbrook-Thompson Holding Corporation | CS66-113 | 06-14-66 | Terminated 09-10-70 |
| Western States Producing Company | CS69-4 | 10-14-68 | |
| Westhoma Oil Company | CS71-91 | | |
| Westmore Drilling Company, Inc. | CS71-173 | | |
| Westrans Petroleum Inc. | CS71-470 | | |
| Wheeler, Roger M. | CS71-369 | | |
| Wheless Industries | CS71-305 | | |
| Wheless, N. H. OEA | CS71-303 | | |
| White, Robert F. | CS71-163 | | |
| Whitley, Frank J. | CS67-50 | 06-22-67 | |
| Whittington, G. R. | CS71-101 | | |
| Wichita Industries Inc. | CS71-390 | | |
| Wichita Resources, Inc. | CS71-13 | 12-11-70 | |
| Wichita Resources 701 Ltd. | CS71-541 | | |
| The Wil-MC Oil Corporation | CS71-291 | | |
| Wilbanks, Bruce A. | CS69-17 | 12-16-68 | |
| Wilbanks & Rasmussen | CS68-31 | | Withdrawn 11-02-67 |
| Wilkenson, Lester | CS71-15 | | |
| Williams, Alfred J. | CS70-36 | 04-20-70 | |
| Williams, Betty M. | CS66-92 | 04-22-66 | |
| Williams, Clayton W., Jr. | CS66-91 | 04-22-66 | |
| Williams Brothers Company | CS68-27 | 02-15-68 | |
| Williams, John W. and Commerce Trust Company, Executors of Estate of Dorsey A. Williams | CS68-52 | 06-17-68 | |

* See footnote on p. 65a.

*Small Producer Certificates, April 30, 1971*—Continued

| *Seller* | *Docket* | *Order Issuing CS Cert.** | *Other* |
|---|---|---|---|
| Williams Properties, Inc. | CS71-176 | 03-17-71 | |
| Williams, Raymond A., Jr. | CS67-6 | 11-14-66 | |
| Williams, Robert L. d/b/a Imperial Oil Company | CS71-272 | | |
| Wilmer Oil Inc. | CS71-389 | | |
| Fred Wilson Drilling Co, Inc. | CS71-339 | | |
| Wilson, Robert P., et al. | CS71-382 | | |
| Wilson, T. B. | CS71-383 | | |
| Wolfson Oil Company | CS66-62 | 07-28-66 | |
| Wolfson, R. P. | CS71-439 | | |
| Wolfson, Sam | CS71-438 | | |
| Wood, John W., Jr. | CS69-69 | 06-13-69 | |
| Wood, McShane & Thams-Colorado | CS70-31 | | Rejected 01-15-70 |
| Woods Exploration & Producing Company, Inc. | CS71-270 | | |
| Woodtex Oil & Gas Company | CS71-138 | | |
| Wray, William R. | CS67-29 | | Returned 01-24-67 |
| Wrightsman Investment Company | CS66-13 | 07-20-66 | |
| Wynne, Robert M. | CS71-305 | | |
| Yale Oil Association, Inc. | CS71-159 | | |
| Yates Petroleum Corporation | CS66-30 | 07-20-66 | |
| Yates, S. P. | CS70-22 | 12-03-69 | |
| Ylnger, W. R. | CS71-128 | 03-19-71 | |
| Yingling Oil, Inc. | CS71-60 | | |
| Youngblood, J. Lee | CS71-76 | | |
| Yucca Petroleum Company | CS66-19 | 04-08-66 | |
| Yuronka, John | CS67-20 | 12-20-66 | |
| Zachary, J. M. | CS66-55 | 06-14-66 | |
| Zallea, James; Zallea, Sol and Lamb, Sidney | CS71-458 | | |
| Zoller, Dorothy Webb | CS66-25 | 09-27-67 | |
| Zoller, Victor H. | CS66-36 | 08-25-66 | |
| Zonne, R. J. | CS69-35 | 04-15-69 | |

* See footnote on p. 65a.

# APPENDIX G

The Natural Gas Act, 15 U.S.C. 717, *et seq.*, provides in pertinent part:

Section 4, 15 U.S.C. 717c:

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject

to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company [1a] or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into

effect;[14] and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Section 5, 15 U.S.C. 717d:

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-

gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

Section 7, 15 U.S.C. 717f:

CONSTRUCTION, EXTENSION, OR ABANDONMENT OF FACILITIES; CERTIFICATE OF CONVENIENCE AND NECESSITY; CONDEMNATION PROCEEDINGS

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transpor-

tation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers,

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona

fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate,

and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided,* That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

Section 16, 15 U.S.C. 717*o*:

ADMINISTRATIVE POWERS OF COMMISSION; RULES, REGULATIONS, AND ORDERS

The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commis-

sion shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

U.S. GOVERNMENT PRINTING OFFICE: 1973

# In the Supreme Court of the United States

OCTOBER TERM, 1972

72-1491

DUDLEY T. DOUGHERTY, ET AL, CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL,
*Petitioners*

*v.*

TEXACO INC., CONSOLIDATED GAS SUPPLY CORPORATION, PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, WARREN PETROLEUM CORPORATION, TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, INC., PHILLIPS PETROLEUM COMPANY

---

*PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA*

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I N D E X

## CITATIONS

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1972

NO. __________

---

ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL
Petitioners

VS.

TEXACO, INC., CONSOLIDATED GAS SUPPLY CORPORATION, PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA, WARREN PETROLEUM CORPORATION, TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO, INC., PHILLIPS PETROLEUM COMPANY

---

PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA

---

The Estate of Mrs. James R. Dougherty, et al, intervenors in the court of appeals in behalf of the Federal Power Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia entered on December 12, 1972, rehearing denied February 5, 1973. This petition is filed in conjunction with the petition filed in the cause by the Solicitor General on behalf of the Federal Power Commission.

## OPINION BELOW

The opinion of the court of appeals (App. A, pp. 1a-22a)* is not yet reported. The initial order (No. 428) of the Federal Power Commission (App. D, pp. 29a-46a), its order (No. 428-A) of amendment (App. E, pp. 47a-49a), and its order No. 428-B) denying rehearing (App. F, pp. 50a-84a) are reported at 45 F.P.C. 454, 45 F.P.C. 458, and 46 F.P.C. 47 respectively.

## JURISDICTION

The judgment of the court of appeals was entered on December 12, 1972 (App. B, pp. 23a-25a). Timely Petition for Rehearing was filed by the Commission and by Petitioner and was denied on February 5, 1973. (App. C, pp. 26a-28a). The jurisdiction of the Court is invoked under 28 U.S.C 1254(1).

## STATUTES INVOLVED

Sections 4, 5, 7, and 16 of the Natural Gas Act, 15 U.S.C. 717(c), 717(d), 717(f), and 717(o), are set forth in App. G, pp. 85a-93a.

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* All references to appendices contained herein are references to the appendices appended to the petition filed by the Solicitor General.

## QUESTIONS PRESENTED

Whether the Natural Gas Act, Section 4(a) of which provides that "[a]ll rates and charges...received by any natural-gas company...shall be just and reasonable..." prohibits the Federal Power Commission from adopting a method of indirect regulation of the wellhead gas rates charged by small producers based upon market factors.

## STATEMENT

The United States Court of Appeals for the District of Columbia in the opinion below, set aside the orders of the Federal Power Commission in docket No. R-393, which are Orders 428, 428-A, and 428-B. These Orders were issued by the Federal Power Commission in a rulemaking proceeding instituted by Notice of Rulemaking issued by the Commission on July 23, 1970. 35 Fed. Reg. 12220. After an opportunity for interested parties to comment had been afforded, the Commission issued Order 428 on March 18, 1971. This order was modified on April 9, 1971 and Order 428-A substituted, and in response to a Petition for Rehearing by interested parties, the Order was again modified on July 15, 1971, in Order 428-B.

In order 428 the Commission promulgated a regulation that relieved producers of less than ten million mcf of gas per year from certain regulatory burdens. The action of the Federal Power Commission was challenged in the court of appeals by petitions filed pursuant to Section 19 of the Natural Gas Act, 15 U.S.C. 717(r)(b) by large producers, pipelines, a state commission, and one small producer. Petitioners intervened in support of the Commission in the court of appeals.

The Federal Power Commission indicated in promulgating Order 428 that the order was designed to help alleviate the growing national crisis resulting from a shortage of natural gas by stimulating the exploratory effort of the small producers, who drill approximately 80% of all the exploratory wells drilled in the United States. The Commission said that "One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By action herein, we are taking an important step to meet this responsibility." App. D, p. 31a. The Commission sought to fulfill this statutory responsibility by establishing a procedure under which small producers could obtain blanket certificates to cover all existing and future sales, by relieving the small producers of certain filing requirements and by relieving small producers of natural gas from the burden of direct price regulation.

Order 428 provided that small producers may collect from large producers and pipeline purchasers the price established by existing contracts between the producers and its purchasers, and, for gas that is sold on a contract negotiated in the future, the negotiated price. These prices were to be collected without regard to the applicable area rates and without refund obligations. The prices paid to small producers were, however, to be reviewed at the pipeline level. Generally, the purchaser would be permitted to pass on the increase subject to the following limitations: First, the flow-through must be allowed by the contract between the purchaser and the purchaser's purchaser. Second, the flow-through will be allowed only if the increase raises the purchaser's

average cost of natural gas more than one mill per mcf. Third, the purchaser must show that the price it is paying to the small producer is not unreasonably high. The criteria for determining whether or not the price is unreasonably high are the "highest contract prices for sales by large producers, or the prevailing market price for intrastate sales in the same producing area." Any increase that a purchaser passes through to its customers will be subject to refund in "either (1) a pipeline rate case, or (2) a proceeding involving only the tracking increase." (App. D, p. 37a).

The Commission continues to require its consent to the abandonment of the sale of jurisdictional gas as specified in Section 7b of the Act. 15 U.S.C. 717(f)(b). Therefore if a small producer is selling natural gas in the interstate market under Order 428 he must continue to sell it in that market at the contract price or area rate even after the original term of the contract has expired.

The Commission hoped to achieve its stated goal of increasing exploration without undue cost to the consumer. The Commission found that in 1969 small producers were selling only 10.52% of the interstate natural gas being sold. And since much of this gas was being sold under contracts negotiated many years ago, allowing the price for this gas to attain its contract price was unlikely to produce a significant price increase. There would be an increase in the cost of gas to consumers only if Order 428 was successful and new gas was found and dedicated to the interstate market. Even the price of such new gas will, however, be subject to viable market controls. The small producers are in a weak bargaining position as compared to the pipelines and

major producers who buy their gas; because of the limitation on the ability of the large producers and pipelines to pass through increases they are given extra incentive to bargain hard; and because of the relatively small market share that small producers have any increase in the price paid for their gas would have a relatively small impact on the price paid by the consumer.

The court of appeals held, one judge dissenting, that Order 428 went beyond the authority of the Commission because it did not insure that the rates at which small producers sold their natural gas would be "just and reasonable." 15 U.S.C. 717(c). Judge Fahy dissented on the grounds that the Commission had the authority to adopt market based regulation if rates producers will be "just and reasonable" and the Commission's assumption that such rates would be produced was not rebutted.

## REASONS FOR GRANTING THE WRIT

The holding of the court of appeals is that the requirement of Sections 4 and 5 of the Natural Gas Act,15 U.S.C. 717(c) and 717(d), that all rates be "just and reasonable" precludes the Federal Power Commission from regulating the price of natural gas by means of market-based-indirect regulation. The court of appeals concluded that regulation by such market factors is the "antithesis of regulation" (App. A, p. 11a, n. 18), and that the essential difference between a regulated and unregulated industry is that "the latter is governed by the market while the former, by definition, is the subject of active governmental control." (App. A, p. 14a). This holding

drastically reduces the Commission ability to provide a regulatory system that achieves the goals of the Natural Gas Act to assure an adequate supply of natural gas at a "just and reasonable" rate.

1. There can no longer be a debate that the United States is now experiencing a natural gas shortage that is most serious nor that imaginative governmental action is necessary in order to prevent a crisis of the first order. See Placid Oil Co. v. FPC, ___ F.2d ___ (5th Cir. 1973) [Slip Op. pp. 23-30, April 16, 1973]; The Hugoton-Anadarko Area Rate Case, 466 F.2d 974 (9th Cir. 1972); City of Chicago v. FPC, 458 F.2d 731 (D.C. Cir. 1971). The central problem is that the United States is consuming natural gas at a rate far in excess of the rate at which natural gas is being found. See Placid Oil Co. v. FPC, supra, ___ F.2d at ___ [Slip Op. at 27]. It is obvious that in order to alievate this shortage it is necessary for the industry to find more natural gas. Since the small producer has traditionally drilled and apparently continues to drill the vast majority of the exploratory wells in the United States, the Commission reasonably concluded that if the exploratory activity of this part of the industry could be expanded there was a great likelihood that there would be an increase in the amount of new gas being found.

In order to stimulate the small producers' exploratory efforts it was necessary for the Commission to provide an incentive for them to explore and provide them with the financial resources necessary to carry on the exploration. It sought to accomplish these goals by providing a market environment in which the small producer would be

able to have the benefits of his success including the benefits of a low-cost operation and the benefits of a contract price which he negotiated in an environment in which he was free from direct constraints.

In the past, the Commission has sought to increase exploration incentives by adding a few cents to the price per mcf necessary to compensate the producer for his cost and to provide a reasonable rate of return. See Austral Oil Co. v. FPC, 428 F.2d 407, on rehearing, 444 F.2d 1257, cert. denied sub. nom, Municipal Distributors Group v. FPC, 400 U.S. 950 (1970); Placid Oil Co. v. FPC, supra. Although the amount of exploration, if any, that a particular number of cents per mcf will produce is inherently unknowable, such incentive factors have been found within the Commission's power to establish. See Austral Oil Co. v. FPC, supra; Placid Oil Co. v. FPC, supra. The basic difference between the incentive payments that have previously been approved and the scheme established in Order 428 was that Order 428 did not set any specific number of cents per mcf at which the natural gas was to be sold. No particular rate or charge was before the court of appeals for scrutiny as to its "justness" or "reasonableness." Instead, Order 428 set up a special kind of market that would provide both financial and psychological incentives to the producer to explore for natural gas and dedicate the natural gas found to the interstate market while at the same time providing protection for the consumers against exploitation by unreasonably high rates.

The court of appeals has read into the words "just and reasonable" a requirement that a specific price be always set by the

regulatory commission. There is no and never has been any such requirement. The terms "just and reasonable" "have no intrinsic meaning applicable alike to all situations." City of Chicago v. FPC, 458 F.2d 731, 750 (D.C. Cir. 1971). There is no holding that the term "just and reasonable" requires that specific price must be set and that market mechanisms can never be relied upon to produce such rates.

Indeed, this Court has made it clear that market factors may be an appropriate basis for determining rates. In Permian Basin Area Rate Cases, 390 U.S. 747 (1968), the Commission determined that rates geared to market prices would not at that particular time produce a "just and reasonable" rate. This Court affirmed that holding as being supported by the record, but refused to foreclose a different result in the future. Specifically this Court stated at 390 U.S. 799:

> "We do not now hold, and the Commission has not suggested, that field prices are without relevance to the Commission's calculation of just and reasonable rates.... The record in subsequent area rate proceedings may more clearly establish that the market mechanism will adequately protect the consumer interest. We hold only that, on this record, the Commission was not compelled to adopt field prices as the basis of its computation of area rates." (Emphasis supplied.)

The Commission, in Order 428, found that the market mechanism in a peculiar mar-

ket, specifically controlled by the Commission would adequately protect the consumer against unjust and unreasonable prices and provide incentive for the exploration for and dedication of new natural gas to the interstate market. The court of appeals, however, concluded that a market mechanism can never be an appropriate device for establishing "just and reasonable" rates. That conclusion is specifically and plainly inconsistent with the conclusion reached by this Court in the Permian Basin Area Rate Cases.

2. The effect of the court of appeals' holding is that the Federal Power Commission must establish some set rate per mcf for the sale of natural gas by all producers of natural gas. The process of such specific determination is inherently cumbersome and time consuming. See Placid Oil Co., supra, [Slip Op. at 2]. While the specific rate determination is proceeding, the exploration for natural gas by small producers will continue to drop and the percentage of natural gas that is found dedicated to interstate market will continue to fall. (Comments of George P. Morrill, R. 65-78). Moreover, as a result of the decision of the court of appeals all funds collected by the 4,600 small producers, pursuant to Order 428, are no longer available to finance exploration for natural gas and in order to insure that funds are available to pay refund claims, present exploration will be curtailed.

## CONCLUSION

For the reasons stated herein and for the reasons stated in the petition filed by the Solicitor General, the petition for certiorari should be granted.

Respectfully submitted,

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Dougherty, et al

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972

FEDERAL POWER COMMISSION, *ET AL.*,
*Petitioners*,

v.

TEXACO INC., *ET AL.*,
*Respondents.*

**On Petitions for Writs of Certiorari**
**To The United States Court of Appeals**
**for the District of Columbia Circuit**

## BRIEF OF THE RESPONDENT, PHILLIPS PETROLEUM COMPANY, IN OPPOSITION

Phillips Petroleum Company ("Phillips"), one of the Respondents in this case, files this brief in opposition to the petitions for *certiorari* lodged in Case No. 72-1490 by the Solicitor General, on behalf of the Federal Power Commission ("Commission"), and in Case No. 72-1491 by Dudley T. Dougherty, *et al.*, Co-Executors of the Estate of Mrs. James R. Dougherty, *et al.* ("Dougherty").[1]

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[1]For convenience, when this brief in opposition refers to "Commission" it may also be understood to refer to Dougherty where appropriate in light of the context.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit (App. la-22a)[2] has recently been reported at 474 F.2d 416 (1972). The initial Order of the Commission, designated Order No. 428 (App. 29a-46a), is reported at 45 FPC 454 (1971); amendatory Orders, designated Order Nos. 428-A (App. 47a-49a) and 428-B (App. 50a-84a), are reported at 45 FPC 548 (1971) and 46 FPC 47 (1971), respectively (said Orders will sometimes be referred to collectively as "Orders").

## QUESTIONS PRESENTED

1. Whether this Court should review a decision holding that, while the Commission may utilize appropriate methods to relieve small producers from certain regulatory burdens, the Commission may not adopt a method which both omits and precludes the statutory application of the "just and reasonable" rate standard of Section 4 to certain jurisdictional sales.

2. Whether this Court should review a decision holding that, while the Commission has power under Section 16 of the Natural Gas Act to classify persons and to issue and promulgate administrative rules and regulations "to carry out" the provisions of the Act, but "for the purposes of its rules and regulations," such power does not include the *legislative* power to *narrow* the applicability of the statutory "just and reasonable" rate standard of Section 4 in clear contravention of the express mandate of Congress.

3. Whether this Court should review a decision setting aside Commission Orders which nullify express statutory mandates especially when the Commission has developed methods (discussed approvingly by the Court below) of achieving its intended goals *within* the framework of the Act.

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[2] "App." refers to the Appendix to the Commission's petition for certiorari.

## STATEMENT OF THE CASE

The facts of this case are ably and concisely stated in the decision of the Court below (App. 1a-22a). Accordingly, Phillips will not comment further on those facts except to point out certain areas in which the Commission's Petition may have left a mistaken impression.

The Commission states that in its Orders it took action "* * * to establish a procedure whereby each small producer could obtain a blanket certificate to cover all existing and future sales * * *" (Petition, p. 7). And it characterizes the decision of the Court below as follows (Petition, p. 8):

> "On petitions for review, the court of appeals, with one judge dissenting, set aside the Commission's orders establishing a blanket certificate procedure for small producers (App. A, *infra*, pp. 1a-22a). The court concluded that, by authorizing blanket certificates for small producer sales, the Commission had abdicated its statutory responsibilities under Sections 4 and 5 of the Act . . . to insure that small producer rates will be 'just and reasonable' * * *."

It seems to Phillips that the above-quoted references may imply that the novelty of the Orders is the blanket certificate procedure -- that it was the blanket certificate idea *per se* which the Court held unlawful. That is not so. The blanket certificate approach for small producer sales was established by the Commission and approved by this Court in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

What must be carefully noted is that the Orders went *beyond* the *Permian* blanket certificate procedure. Under the blanket certificate procedure approved in *Permian*, small producers were relieved of filing requirements, but only so long as their sales were made at or below the just and reasonable area rate fixed by the Commission.[3] Here, however, as the

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[3] Area Rate Proceeding, *et al.*, Opinion No. 468, 34 FPC 159, 234-36 (1965); Order No. 308, Docket No. R-279, 34 FPC 1202 (1965).

Commission conceded (App. 14a), its Order "* * * does not purport to determine the just and reasonable rates for sales by small producers." The Orders here would permit small producers to charge their contract rates (App. 43a), regardless of the just and reasonable area rate, without any prior review of either the contract or the contract rate by the Commission.

Further, since the orders would have allowed exaction of unreviewed contract rates by small producers without any obligation to refund overcharges in excess of a subsequently determined just and reasonable rate, the Orders would have forever insulated those (past) sales from regulation under the just and reasonable standard. Indeed, as the Court pointed out, if the Commission had left even the potential for future review under the just and reasonable standard of Sections 4 and 5 of the Natural Gas Act ("Act")

> "* * * we might have a different case. * * * However, the Commission here abandoned *any* future rate review under the 'just and reasonable' standard * * *" (App. 13a at note 21; emphasis in original).

The Commission's Petition also states that the holding of the Court below was "* * * that the Commission may not rely on market factors in reviewing the lawfulness of small producer rates * * *" (Petition, p. 12). Dougherty raises the same point (Petition, pp. 9-10). With all due deference to Petitioners, that was *not* a holding of the Court below as we point out in our argument.

Another fact should also be noted. The Court below indicated that the Commission is free to determine "just and reasonable" rates for small producer sales which are higher than the just and reasonable area rates that apply to sales of other producers (App. 16a). The Court said that "* * * [g]iven the special problems and practices of small producers, such a result is certainly conceivable * * *" *(ibid.)*.

Also, the Court discussed approvingly Order Nos. 455

and 455-A,[4] orders issued by the Commission after the Orders under review (App. 13a). Order Nos. 455 and 455-A, which expressly apply to small producers (and others), promulgate optional procedures by which the Commission, before a sale begins, will act to approve or disapprove contracts proposing rates that exceed current area rates. Under the optional procedure, before the sale is certified the Commission will determine whether the specified (present and future) contract prices in excess of area rates "* * * are just, reasonable and required by the present and future public convenience and necessity," the Standards of Sections 4 and 7, respectively (Appendix A, *infra*, p. 32a). The Court said that such a procedure appears to comport more with the Act than the small producer Orders which preclude review under the just and reasonable standard (App. 13a).

## ARGUMENT

There is no question raised by the Petitions warranting the grant of *certiorari*. The alleged importance of this case as represented by the Commission and Dougherty derives solely from incorrect interpretations of the decision and the failure of Petitioners to recognize other administrative remedies – most already available – to provide almost the same relief to small producers without abandoning the "just and reasonable" standard.

1. Commission in its Petition (pp. 12-14) tries to create the illusion of importance for this case by saying that the Court of Appeals held that the Commission may not rely on market factors in reviewing the lawfulness of small producer rates in the context of pipeline rate proceedings. The Court said no such thing. It held only that at *some* point in time there must be an application of the "just and reasonable" standard to the small producers' rates.

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[4]Order Nos. 455 and 455-A, issued in Docket No. R-441 on August 3, 1972 and September 8, 1972, respectively, are published at 37 F.Reg. 16188 and 37 F.Reg. 18721, respectively. For convenience, they are printed in Appendix A and Appendix B to this brief, infra.

The Commission ignores the fact that the Court carefully refrained from attempting to prescribe the content of the just and reasonable standard. The Court rejected the Commission's plan, not because market forces were or would be considered in fixing "just and reasonable" rates for such sales, but because the "just and reasonable" standard had been abandoned altogether. Thus, it said:

> "* * * As the court noted in *City of Detroit*, a new Commission approach to regulation is not invalid merely because it departs from the traditional rate-base or cost-of-service methods. However, even granting the legitimacy of indirectly regulating small producer rates, the standards set forth in Order No. 428 have not been demonstrated to have *any relationship at all* to the statutory standard" (App. 12a, footnote 20, emphasis supplied).

Further the Court did not forbid the use of market factors by the Commission, but it noted that the Commission by its Orders was proposing to use brand-new tests nowhere to be found in the Act[5] instead of the statutory "just and reasonable" standard. Resort to such non-statutory standards does not satisfy the congressional mandate that the just and reasonable standard be applied.

There is then no issue as to what the Commission may or may not consider in fixing just and reasonable rates for jurisdictional small producer sales. The issue raised by the Orders was whether the Commission can lawfully refuse to apply the "just and reasonable" standard at all. And as to that issue, the Court said it cannot: Section 4 requires that

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[5] "* * * The novel tests proposed are nowhere spelled out in the Act or in any decision applying the Act. Small producer rates can only be passed along to consumers if they are not

> unreasonably high, considering appropriate comparisons with *highest contract prices* for sales by large producers *or* the prevailing market price for *intrastate* sales in the same producing areas" (App. lla; emphasis in original).

"[*a*]*ll* rates and charges made . . . by *any* natural-gas company . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful."[6]

2. The Commission also tries to create an importance for this case by stating that the Court of Appeals has not given a broad enough scope to the Commission's power to classify under Section 16 of the Act. It states its disagreement with the Court's conclusion that the Orders misuse Section 16 (Petition, p. 11) and then goes on to argue, without any further reference to Section 16, that somehow the substantive standards of the Act would still be applied under its Orders (*id.*, pp. 11-12).

We have just seen that the Court of Appeals rejected the Orders because they do not provide for application of the just and reasonable standard of Section 4. Further, as to the Commission's belated suggestion that Section 5 of the Act would be used to order prospective rate reductions (Petition, p. 12), it should be noted that even if the Section 5 remedy were available under the wording of the blanket certificate provisions,[7] there is still no answer to the Court's objection that purchasers who have been charged illegal rates could never be reimbursed for past excess charges (App. 15a).[8]

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[6]15 U.S.C. §717c(a), emphasis supplied.

[7]In view of the Commission's assurance that "[s]mall producers certificated hereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract" (App. 43a), the subsequent availability of the Section 5 remedy may not be free from doubt. See, *e.g.*, United States v. Seatrain Lines, 329 U.S. 424 (1947).

[8]Significantly, even Judge Fahy in dissent concluded that he would * * * strike its [the Order's] provisions prohibiting refunds to pipelines and large producers, leaving open to the Commission to exercise such authority as it has to protect large producers and pipelines in the event the Commission finds they have been charged unreasonably high prices by small producers * * *" (App. 22a).

Since the Orders freed small producers from refund obligations (App. 5a, 37a), the just and reasonable standard of Section 4 would *never* be applied to some jurisdictional sales.

What is important, in addition, is that there is no conflict between the Court's holding with respect to the Section 16 power to classify and the Section 4 and 5 obligations to set just and reasonable rates. The Commission's brief tries to create such a conflict but fails in the face of the Court's insistence that Section 16 of the Act be used, not to create exemptions, but only in order "* * * 'to carry out the provisions of this chapter,' * * *" that is, "* * * for implementation of the core sections of the Act, such as Section 4" (App. 10a).

The holding of the Court of Appeals is really very straightforward concerning the core sections of the Act:

> "The Commission has a duty to insure that all rates are 'just and reasonable.' At best, the indirect controls it has proposed will insure that the small producer rates which are passed on to consumers are below levels set by private contracting parties (or potentially by state regulation which is not necessarily tied to the federal standard). Nothing at all insures that those levels will be 'just' or 'reasonable.' *That is the essential flaw in the Commission's plan.* That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing" (App. 12a-13a, emphasis supplied).

3. The decision below does not merit review for the additional reason that administrative remedies are already available which afford nearly all of the relief to small producers contemplated by the Orders, but within the framework

of the Act. Since they are available without sacrificing the "just and reasonable" standard, obviously the Commission's attempted justification of its Orders on the basis of the gas supply shortage or any other rationale must be rejected. We shall briefly review these administrative remedies in our remaining comments.

First, the blanket certificate procedures approved by this Court in *Permian, supra,* have been made available in other pricing areas as well.[9] This approved blanket certificate procedure, which can easily be further expanded to include the few parts of the nation not already included, allows small producers to make jurisdictional sales at or below just and reasonable area rates under blanket certificates without making the normal individual rate or certificate filings.

Second, the Court suggested that the Commission is free to fix just and reasonable rates for small producers which are higher than just and reasonable rates for other producers (App. 16a). The benefits of such higher rates can be quickly accorded to small producers as the Commission itself has demonstrated through procedures it has recently employed. Thus, such rates could be established promptly under the *rulemaking* procedures being used by the Commission for fixing "just and reasonable" producer rates,[10] which procedures were recently affirmed by the United States Court of

[9] Area Rate proceeding (Southern Louisiana Area), Opinion No. 598, as amended, 46 FPC 86 (1971), affirmed, Placid Oil Company v. Federal Power Commission, F.2d (5th Cir. No. 71–2761, decided April 16, 1973); Area Rate Proceeding (Hugoton-Anadarko Area), Opinion No. 586, 44 FPC 761 (1970), affirmed, California v. Federal Power Commission, 466 F.2d 974 (9th Cir. 1972); Area Rates for the Appalachian and Illinois Basin Areas, Order No. 411, 44 FPC 1112 (1970); Area Rate Proceeding (Other Southwest Area), Opinion No. 607, as amended, 46 FPC 900 (1971), appeal pending, Shell Oil Company v. Federal Power Commission (5th Cir. No. 72-1114).

[10] Area Rates for the Appalachian and Illinois Basin Areas, Order No. 411, 44 FPC 1112 (1970).

Appeals for the Tenth Circuit.[11] A recent example illustrating the speed of these new ratemaking procedures is in the Commission's Docket No. R-389-B wherein, on April 11, 1973, the Commission gave notice that it would fix a nationwide "just and reasonable" rate for new gas sales by July 1, 1973.[12]

Finally, it is plain from the decision that the Court was favorably impressed with the so-called optional certificate procedure which is already available under the Commission's regulations.[13] Producers desiring to make jurisdictional sales at rates exceeding area rate levels may file applications for certificates under the optional certificate procedure. Commission approval of such applications will be after scrutiny of the sale under both the just and reasonable standard of Section 4 and the public convenience and necessity standard of Section 7. Such optional certificates, when granted, will approve the higher contract rates over the life of the contract under both statutory standards.

As the following excerpt makes clear, the optional certificate procedure, including application of the just and reasonable standard, was represented by the Commission to be the *most* it can do under the Act to assure independent producers that they will be able to collect their contract prices:

> "24. To those who have commented on our rulemaking to suggest that we exceed our authority in contemplating permanent certification of producer sales at firm rates not subject to refund or

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[11] "Notice Instituting Proposed Rulemaking and Order Prescribing Procedure," Docket No. R-425, issued July 15, 1971, 36 F.Reg. 13621, affirmed, Phillips Petroleum Company, et al. v. Federal Power Commission. F.2d (10th Cir. Nos. 71-1659, et al., decided February 20, 1973).

[12] "Notice of Proposed Rulemaking and Order Prescribing Procedures," Docket No. R-389-B, issued April 11, 1973, 38 F.Reg. 10014, mimeo, p. 11: "We intend to issue an order on the merits in this proceeding by July 1, 1973."

[13] Order Nos. 455 and 455-A, supra, reproduced as Appendix A and Appendix B, infra.

reduction in later area rate proceedings, we answer by our foregoing acknowledgment of the supremacy of Section 5 over our administrative regulations and determinations. We cannot bind a future Commission not to invoke the prospective operation of Section 5, nor do we attempt to do so. We do, however, announce our policy to examine the justness and reasonableness of proposed rates in Section 7 proceedings instituted under this Section, thus avoiding the uncertainty of reserving rate determinations for subsequent Section 4 or Section 5 action. *To the extent that this Commission can grant certainty of rates, we do so.* Congressional enactment of sanctity of contract legislation is essential to assure that contracts dedicating new supplies to interstate markets will not be abrogated by future commissions."[14]

The Commission thus stated that its optional procedure, premised on a determination after a hearing that the proposed contract rates are just and reasonable, is as far as it can go in granting sanctity of prices in producer contracts. Clearly sanctity of contract rates cannot lawfully be achieved under the Act by abandoning the statutory "just and reasonable" standard as the Commission attempted to do in the Orders which the Court below set aside.

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[14]Order No. 455, mimeo, pp. 9-10, emphasis supplied (infra, Appendix A, p. 10).

## CONCLUSION

In light of the foregoing, it is submitted that the decision of the Court of Appeals is correct in that there are no reasons warranting grant of *certiorari* by this Court. Accordingly, the petitions for a writ of *certiorari* should be denied.

Respectfully submitted,

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June 1, 1973

## CONCLUSION

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## APPENDIX A

## UNITED STATES OF AMERICA
## FEDERAL POWER COMMISSION

(18 CFR 2.75)

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Pinkney Walker,
and Rush Moody, Jr.

Optional Procedure for Certificating ) Docket No. R-441
New Producer Sales of Natural Gas)

## ORDER NO. 455

## STATEMENT OF POLICY RELATING TO OPTIONAL PROCEDURE FOR CERTIFICATING NEW PRODUCER SALES OF NATURAL GAS

(Issued August 3, 1972)

1. Pursuant to the Administrative Procedure Act, 5 U.S.C. 551, *et seq.* (1967) (APA) and Sections 4,5,7,8,14,15, and 16 of the Natural Gas Act[1], the Commission issues rules fixing the terms and conditions of an optional procedure under which it will issue permanent certificates for, and will otherwise regulate sales of natural gas subject to the Commission's jurisdiction nationwide, including, but not limited to, the Southern

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[1] 52 Stat. 822, 823, 824, 825, 828, 829, 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72; 15 U.S.C. 717c, 717d, 717f, 717g. 717m, 717o.

Louisiana, Permian Basin, Other Southwest, Hugoton-Anadarko, Texas Gulf Coast, Appalachian and Illinois Basins, Rocky Mountain areas, and all other areas. The rates embodied in certificates issued pursuant to the rules and amendments set forth herein will be firm rates, not subject to refund obligation, as will be more fully explained hereinafter.

2. As we state in the notice issued in this proceeding on April 6, 1972, (37 FR. 7345, 4/13/72), data available to the Commission indicates a worsening of the gap between natural gas demand and supply.

3. The recent report on "National Supply and Demand 1971-1990," prepared by the Federal Power Commission's Bureau of Natural Gas (BNG) shows the level of "unsatisfied demand" for gas increasing from 3.6 trillion cubic feet in 1975 to 9.5 trillion cubic feet in 1980, 13.7 trillion cubic feet in 1985 and 17.1 trillion cubic feet in 1990.[2] Additionally, it is estimated that between 1971 and 1990, the United States will require 186.4 trillion cubic feet more gas than will be available, even after making liberal allowances for pipeline imports, liquefied natural gas imports, coal gas, Alaskan gas and reformed gas.[3]

4. The Future Requirements Committee (FRC) estimates that the natural gas requirements for the United States will increase from about 28.2 trillion cubic feet in 1971 to 33.9 trillion cubic feet in 1975.[4] Based on information concerning presently contracted or reasonably assured supplies, the FRC estimates that the gap between the potential demand for gas

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[2] *National Gas Supply and Demand 1971-1990,* and Bureau of Natural Gas, Federal Power Commission, February 1972, p. 3.

[3] *Ibid.*, p.3.

[4] *Future Gas Requirements of the United States,* Future Requirements Committee, Vol. No. 4, October 1971, p. 3.

and the most likely available supply will increase from .9 trillion cubic feet in 1971 to 3.9 trillion cubic feet in 1975.[5]

5. The assurance of adequate supplies of natural gas can mitigate the damage being done to the nation's environment. Natural gas is the cleanest burning and least polluting of all the fossil fuels.

6. Any further aggravation of the gas supply problem also portends grave implications for the nation's economic objectives. Between 1947 and 1970, the nation increased its annual consumption of energy from 32.9 quadrillion Btu to 68.8 quadrillion Btu, with the share of the total being contributed by natural gas increasing from 13.8 percent in 1947 to 32.5 percent in 1970.[6] During this period, the nation's real output of goods and services more than doubled and its real income per capita increased by about one half. It is inescapable that the continued growth and productivity of the U.S. economy requires adequate and reliable supplies of energy, including adequate and reliable supplies of natural gas.

7. Moreover, our efforts to hold consumer costs to the lowest reasonable level can only be eroded if the nation is forced to rely more heavily on substitute or supplemental supplies of gas than would be required if our domestic natural gas resources were developed in a timely manner. New base load supplies of substitute or supplemental gas will be available to consumers only at costs significantly higher than the prices of currently available domestic wellhead supplies.[7] The price per Btu for many primary fuels is greater than the price per Btu for natural gas. This comparison is especially unfavorable to the

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[5] *Ibid.*, p.3.

[6] *Mineral Industry Surveys, Petroleum Statement Monthly*, Bureau of Mines, Department of Interior, December 1970, p. 37.

[7] See, e.g., *Distrigas Corp.*, Docket No. CP70-196, *et al.*, opinion Nos. 613 and 613A, issued March 9 and June 7, 1972, respectively, Columbia LNG Corp., *et al.*, Docket Nos. CP71-68, *et al.*, opinion No. 622, issued June 28, 1972.

alternative fossil fuels when the costs of storage, handling and pollution control are included. In summary, if our domestic natural gas resources are not developed in a timely manner and consumers of natural gas are forced to satisfy a commensurately larger portion of their energy requirements by using either substitute or supplemental gas supplies, *e.g.*, imported liquefied natural gas, propane, reformed hydrocarbons, gasified coal, imported natural gas, or other fossil fuels, the net effect is higher energy costs throughout the economy, with resulting inflationary pressures. Higher prices for domestic gas, if paid for new supplies, will result in a cheaper mix of energy supplies and thus represent a better alternative.

8. In view of these facts, we are unwilling to leave untested the producing capacity of the United States. Our responsibility to the consumers of natural gas, to assure reliable and adequate supplies at the lowest reasonable cost, impels us to that course of action best calculated to spur domestic exploration and development. To this end, we seek to provide two incentives to domestic production, both fully congruous with consumer protection. First, we will certificate sales of gas not previously deliverable to the interstate market at prices which are shown to be in the public interest. Second, to the extent possible, we will lessen rate uncertainty which has prevailed since the early 1960's.

9. Studies available to the Commission indicate that vast quantities of natural gas remain undeveloped in the United States. Estimates range from 1178 trillion cubic feet to 2100 trillion cubic feet. We seek accelerated development of that portion of this potential supply which is economically recoverable, for in development of domestic reserves lies the best assurance of reliable supplies at the lowest reasonable cost.

10. As will be stated more fully hereinafter, this policy statement and the optional procedures herein established are directed at supplies of gas not available to the interstate market prior to April 6, 1972. The rulemaking does not envisage nor authorize rate increases for gas already flowing in interstate commerce through wells drilled prior to April 6, 1972. As new supplies are found or reduced to a deliverable state for

dedication to the interstate consumer market, the optional procedures here set forth will become available, but because of the limited scope of this rulemaking, consumers will not pay higher rates except for new supplies, and then only to that extent that the contracting parties establish on the record that the price to be paid is required by the public interest.

11. While comments were received from various persons, groups, and associations, we take particular note of those of the Departments of Commerce and Interior and the Environmental Protection Agency. The Department of Commerce suggested certain amendments to the rule as noticed, which have been adopted here, and expressed support for the proposed rule-making to encourage gas exploration and development. The Department of the Interior likewise suggested certain modifications in the rule, many of which have been accomplished by our action here, and stated, "(t)he proposed rule-making order in Docket No. 441 is a strong step toward providing the necessary incentive that will stimulate exploration and development of new gas supplies. . . ." The Environmental Protection Agency concurred "in the FPC's efforts to try to improve the gas supply position through procedures which will allow for increased reliance on market incentives."

12. Ninety-three persons, groups, Commissions or associations filed comments or suggestions in response to the Notice of April 6, 1972.[8] A number of those responding to the notice raised a general question of the lawfulness of the rule as proposed. We shall discuss procedural issues first and then discuss *seriatim* the suggestions and comments applicable to the various provisions of the rules.

## PROCEDURAL ISSUES

13. An understanding of the relationship between the optional certification procedure we adopt herein and area rates must be based on an appreciation of the interplay between the Section 7 certificate and Sections 4 and 5 rate provisions of the Natural Gas Act (Act). That relationship is particularly

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[8] A list of said respondents is contained in the Appendix hereto.

important insofar as regulation of producers' sales of natural gas in interstate commerce is concerned.

14. Immediately following the issuance of the Supreme Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), holding that sales of natural gas by producers for resale in interstate commerce are subject to the Act, the Commission initiated producer regulation by issuing Order Nos. 174 (13 FPC 1194), 174-A (13 FPC 1255), and 174-B (13 FPC 1576), requiring independent producers to file applications for certificates of public convenience and necessity, pursuant to Section 7 of the Act, and to file their contracts, under which interstate sales were being made or were proposed to be initiated, as rate schedules pursuant to Section 4 of the Act.

15. The Commission attempted individual company cost-of-service rate regulation following the issuance of Orders 174, 174A and 174B. The resultant delays and uncertainty were of such magnitude that this system of producer rate regulation was clearly not in the public interest. Before this was fully recognized, contracts were filed in the *CATCO* case [*The Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (1959)] providing for an initial price of 21.4 cents per Mcf.

16. Because of opposition to the increased initial price, the Commission first issued a certificate authorizing the sale upon the condition that the producers could charge no more than 17 cents per Mcf. Since the producers had not commenced delivery of gas, they exercised their prerogative under the Act and declined to accept a certificate conditioned to 17 cents. After rehearing, the Commission issued a certificate (17 FPC 880 (1957)) authorizing the sale at the proposed initial price of 21.4 cents per Mcf because the Commission believed it was important to make certain that the large volume of gas involved (approximately 1.3 trillion cubic feet) be obtained for the interstate market. Additionally, the Commission found that consumers would be protected because of the rate sections of the Act which would enable it to reduce the price prospectively if the 21.4-cent price should prove to be unjust and unreasonable after a hearing held under Section 5 of the Act.

17. The Commission's order was ultimately appealed by the New York Commission and Eastern distributor companies to the Supreme Court. The Supreme Court reversed the order, ruling that the Commission was under a duty to hold the line on prices under the certificate provisions of the Act pending the outcome of rate proceedings instituted under Sections 4 and 5 of the Act (*CATCO, supra,* 360 U.S. at 388-390). The Court pointed out that rate proceedings are normally quite time consuming and that the public should not have to pay the 21.4 cent rate while a just and reasonable rate was being determined.

18. A large number of Commission orders, which had granted certificates approving initial rates on the theory that the prices could ultimately be reduced after the completion of subsequent rate proceedings, were reversed by various United States courts of appeals.[9] After the courts' reversal of Commission orders, the Commission instituted a uniform program of conditioning producer prices in certificate proceedings so as to fix initial prices for new sales to the level of previously certificated sales. The courts consistently affirmed this rationale employed by the Commission,[10] which was a result of its refusal to consider the justness and reasonableness of the price at the time the certificate was issued.

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[9] *United Gas Improvement Co.* v. *F.P.C.*, 283 F.2d 817 (9th Cir. 1960), *cert. denied*, 365 U.S. 881; *United Gas Improvement Co.* v. *F.P.C.*, 287 F.2d 159 (10th Cir. 1961); *United Gas Improvement Co.* v. *F.P.C.*, 290 F.2d 147 (5th Cir. 1961), *cert. denied*, 366 U.S. 965; *United Gas Improvement Co.* v. *F.P.C.*, 290 F.2d 133 (5th Cir. 1961), *cert. denied*, 386 U.S. 823; *P.S.C. of New York* v. *F.P.C.*, 287 F.2d 146 (D.C. Cir. 1960), *cert. denied*, 365 U.S. 880.

[10] *Signal Oil Co.* v. *F.P.C.*, 238 F.2d 771 (3rd Cir. 1956), *cert. denied*, 353 U.S. 923; *P.S.C. of New York* v. *F.P.C.* 329 F.2d 242 (D.C. Cir. 1964), *cert. denied*, 377 U.S. 963, affirming "in-line" price determinations but requiring further consideration of refund conditions; *People of State of California* v. *F.P.C.*, 353 F.2d 16, (9th Cir. 1965); *F.P.C.* v. *Sunray DX Oil Co.*, 391 U.S. 9 (1968).

19. The Commission adhered to a separation of certificate and rate issues when it embarked on area rate regulation. Sales were certificated, but conditioned so that the just and reasonable rate to be charged was not established until final judicial review of the applicable area rate decision was completed.

20. After the Commission had issued its first area rate decision involving the Permian Basin area (opinion No. 468, *Area Rate Proceeding,* 34 FPC 158 (1965), *aff'd, Permian Basin Area Rate Cases,* 390 U.S. 747 (1968), efforts were made by producers to obtain initial prices, pursuant to Section 7, in excess of the just and reasonable rates fixed, pursuant to Section 4 and 5, in the area rate proceeding. The Commission held that area rates would be used to establish the level of the initial rate for new sales, and, therefore, that it would not hold a hearing under Section 7 to determine new "in-line" rates once just and reasonable rates had been established. The Commission's position was upheld in *Phillips Petroleum Co.* v. *F.P.C.,* 405 F.2d 6 (10th Cir. 1969), and *Hunt Oil Co.* v. *F.P.C.,* 424 F.2d 982 (5th Cir. 1970), even though the producers had contended that they should be permitted to introduce evidence showing that their 1968, 1969 and 1970 costs had increased so as to require a higher price than the rate level fixed on 1960 costs by the Commission in the *Permian Basin* area rate proceeding. The court said the producers were attempting in a Section 7 proceeding to make a collateral attack on the area rate proceeding, and that they should ask for a reopening of the area rate proceeding if the prices established therein were inadequate (424 F.2d at 98).

21. At the present time, the Commission has completed area rate hearings in all but the Rocky Mountain area[11] and has fixed just and reasonable rates for all the major producing areas

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[11] *Area Rates for the Rocky Mountain Area,* Docket No. R-425, "Notice Instituting Proposed Rulemaking and Order Prescribing Procedure", issued July 15, 1971.

in the lower 48 States.[12] Court review is pending as to all of the recent area rate opinions[13] except Order No. 411 involving the Appalachian and Illinois Basin areas.

22. Because our area rate orders remain under attack, at the present time a producer, even if he is willing to sell at the rates fixed in such opinions, does not know that those rates will be affirmed on appeal. Although in the *Sunray DX* case supra, 391 U.S. 9, the Supreme Court held that a producer cannot be required to refund below the permanently-certificated rate, the Supreme Court was not in that case ruling on the question of whether a certificated rate, based upon an area rate invalidated through court review, would necessarily be impregnable, and the certificates so indicate. Consequently, there is no assurance at the present time that a producer may not ultimately have to refund some of an initial rate based on a just and reasonable

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[12]In addition to the *Permian Basin* decision *supra*, the Commission has instituted a new *Permian Basin* proceeding (*Area Rate Proceeding (Permian Basin Area)*, Docket No. AR70-1, 45 FPC 192 (1971)) which is awaiting an Examiner's initial decision. In addition to the first *Southern Louisiana Area Rate Proceeding* (Opinion No. 546, *Area Rate Proceeding (Southern Louisiana Area)*, 40 FPC 530 (1968), *aff'd sub nom. Austral Oil Co. (Southern Louisiana Area Rate Cases)* v. *F.P.C.*, 428 F.2d 407 (5th Cir. 1970), *cert. denied*, 400 U.S. 950), the Commission has issued a second decision regarding the Southern Louisiana area (Opinion No. 598, *Area Rate Proceeding (Southern Louisiana Area)*, Docket Nos. AR61-2, et al., issued July 16, 1971). Area rate opinions have also been issued for four other important producing areas: Opinion No. 607, *Area Rate Proceeding* (other Southwest Area), Docket Nos. AR67-1, *et al.*, issued October 29, 1971; Opinion No. 595, *Area Rate Proceeding (Texas Gulf Coast Area)*, Docket Nos. AR64-2, *et al.*, issued May 6, 1971; Opinion No. 586, *Area Rate Proceeding (Hugoton-Anadarko Area)*, Docket Nos. AR64-1, *et al.*, issued September 18, 1970, 44 FPC 761; and Order No. 411, *Area Rates for the Appalachian and Illinois Basin Areas*, Docket No. R-371, issued October 2, 1970, 44 FPC 1112, and Order No. 411-A, issued October 30, 1970, 44 FPC 1334.

[13]Opinion No. 586 in Ninth Circuit No. 71-1036, Opinion No. 595 in CADC 71-1828; Opinion No. 598 in Fifth Circuit Nos. 71-2761; *et al.*; Opinion No. 607 in Fifth Circrcuit Nos. 72-1114, *et al.*

determination and upon which the producer relied when it dedicated a new gas supply to the interstate market. In short, after some 18 years of producer regulation, the producer does not know how much it can lawfully charge for sales of natural gas in interstate commerce nor how much it will get if it develops and sells new gas to the interstate market. The producer knows for sure only that once it sells in interstate commerce it cannot stop deliveries.

23. This uncertainty has impeded domestic exploration and development. We acknowledge that Section 5 of the Natural Gas Act prevents the Commission from granting sanctity of contract, and that a degree of uncertainty will remain so long as Congress withholds action on sanctity of contract legislation. We continue to urge the necessity for sanctity of contract legislation, in the firm belief that Congressional action in this field will establish a reasonable level of prices consistent with adequate service to the consumer by encouraging development of required supplies and by avoiding uncertainty factors in producer pricing, thereby attracting capital at risk at a lower return than would otherwise prevail.

24. To those who have commented on our rulemaking to suggest that we exceed our authority in contemplating permanent certification of producer sales at firm rates not subject to refund or reduction in later area rate proceedings, we answer by our foregoing acknowledgment of the supremacy of Section 5 over our administrative regulations and determinations. We cannot bind a future Commission not to invoke the prospective operation of Section 5, nor do we attempt to do so. We do, however, announce our policy to examine the justness and reasonableness of proposed rates in Section 7 proceedings instituted under this Section, thus avoiding the uncertainty of reserving rate determinations for subsequent Section 4 or Section 5 action. To the extent that this Commission can grant certainty of rates, we do so. Congressional enactment of sanctity of contract legislation is essential to assure that contracts dedicating new supplies to interstate markets will not be abrogated by future commissions.

25. Since mid-1969, the Commission has attempted in several ways to obtain new supplies of gas for the interstate

market. One was the announcement in Paragraph 12 of its Statement of Policy in Docket No. R-389A issued July 17, 1970, 35 Fed. Reg. 11638, of its willingness to consider applications proposing to make sales at initial prices above area rate ceilings. Relatively few filings have been made under Paragraph 12, because certificates thereunder are conditioned to later area rate determinations and are therefore subject to the same uncertainties as have impeded domestic development in the past.

26. Another of our efforts to alleviate the gas shortage was the authorization for emergency purchases. Among other features, this program involved experimentation with the use of an expedited certification procedure which encompassed a determination of a lawful rate. In proceedings under Orders 402 (May 6, 1970, 43 FPC 707), 418 (December 10, 1970, 44 FPC 1574) and 431 (April 15, 1971, 45 FPC 570), all certification and rate issues are determined in one proceeding. Since the effective date of Order 431, we have issued 62 certificates at prices ranging from 26¢ to 40¢/Mcf. Approximately 500 Bcf of gas have been brought to the interstate market through this procedure. Neither the Order 431 procedure itself, nor any certificate issued under it has been the subject of legal attack, and we have been able to act upon certificate applications by final order issued, on the average, less than two months after the application was filed. The results of our experiment strongly indicate that producer rate regulation can be efficiently managed, in the public interest, by reaching certificate and rate issues in one proceeding, particularly if we use the abbreviated hearing process open to us under our statutes and rules.

27. The disadvantages to the Order 431 sales which have been made under the foregoing emergency regulations are two: First, on the whole no long-term dedications of reserves to pipeline companies have resulted from such sales. While the temporary sales have been of value in reducing pipeline and distributor curtailments in deliveries which otherwise would have resulted, the fact remains that the gas reserve life indices of the interstate pipeline have continued to decline. Second, Order 431 procedures are available only if the pipeline purchaser is in an emergency gas shortage situation.

28. These two disadvantages make Order 431 procedures an incomplete answer to the gas supply problem. Long-term dedications are essential to reliability and continuity of supply, and to pipeline financing. And secondly, we seek to prevent emergency conditions from developing, rather than responding after an emergency develops.

29. It should be made clear that the optional procedure is not intended to supersede the procedures currently being followed in the area rate proceedings. The area rate opinions have established rate levels for new and flowing gas sales that are currently being made, and parties may continue to operate under these procedures. This is an alternate procedure which is available if the producer is willing to forego certain benefits of area rate proceedings, in exchange for certainty of its certificated price, as determined at the certificate stage.

30. As the Supreme Court pointed out in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. at 602, 64 S.Ct. at 28, and in *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575 at 586 (1942), the Commission must make "pragmatic adjustments" in rate procedures to stimulate the discovery and dedication of gas supplies to the interstate market.

31. By the procedures adopted herein, the Commission now seeks to stimulate the immediate introduction of new, long-term gas supplies into the interstate market by such a pragmatic adjustment. Thus it is proceeding under its certificate authority under Section 7 of the Act. It is unquestioned that the Commission is authorized to vary the initial terms and conditions of a contract for the sale of natural gas in interstate commerce by Section 7 of the Act. Section 7(e) of the Act authorizes the Commission "to attach to the issuance of the certificate * * * such reasonable terms and conditions as the public convenience and necessity may require." In *CATCO* (*supra*) the Supreme Court held that the "Act does not require a determination of just and reasonable rates in a §7 proceeding as it does in one under either §4 or §5." *Id.* at 390-1. However, neither the Act, or any decision, prohibits consideration of whether the rate is just and reasonable.

32. In determining the terms and conditions under which it will issue certificates under Section 7, the Commission need not fix such terms and conditions in each proceeding, but may promulgate those of a general nature under its rulemaking authority.

The Commission's rulemaking authority emanates from Section 16 of the Act, 15 U.S.C. §717o, which states in pertinent part that:

> The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. * * *[14]

33. The Supreme Court has explicitly held "that the statutory requirement for a hearing under §7 does not preclude the Commission from particularizing statutory standards through the rule-making process * * *." *F.P.C.* v. *Texaco*, 377 U.S. 33, 39 (1964). The Court held that the Commission may properly conclude that protection of the consumer interests will be best achieved if done at the threshhold of certification, citing legislative history which is particularly pertinent to the Commission's purpose in promulgating an optional procedure herein:

> * * * The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, *the adequacy of the gas reserves*, the feasibility and adequacy of the proposed services,

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[14]This section of the Act has been broadly construed by the Courts. *Mesa Petroleum Co.* v. *F.P.C.*, 441 F.2d 182 (CA5, 1971). In *Mesa*, the Fifth Circuit stated the Commission's agency discretion is at its zenith when enforcing its regulatory authority. *Id.* at 187. Compare *Niagara Mohawk Power Corp.* v. *F.P.C.*, 379 F.2d 153 (CADC, 1967). See also *F.P.C.* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145, 150-5 (1962); *Superior Oil Co.* v. *F.P.C.*, 322 F.2d 601, 610 (CA9, 1963), Certiorari denied, 377 U.S. 922 (1964), rehearing denied, 377 U.S. 960.

> *and the characteristics of the rate structure* in connection with the proposed construction or extension *at a time when such vital matters can readily be modified as the public interest may demand* * * * [emphasis supplied] (H.R. Rep. No. 1290, 77th Cong., 1st Sess., pp. 2-3, and see S. Rep. No. 948, 77th Cong., 2nd Sess., pp. 1-2).

34. Recently, the United States Court of Appeals for the District of Columbia Circuit stated that "many of the same regulatory objectives which can be attained through *ad hoc* proceedings under Section 4, 5 and 7 can also be attained through the issuance of general rules under Section 16." *City of Chicago* v. *F.P.C.*, 458 F.2d 731, 743 (CADC, No. 23740) decided December 2, 1971, cert. denied April 17, 1972.

35. In affirming *Permian* (*supra*) the Supreme Court noted (360 U.S., at 772):

> The Commission quite reasonably believed that the terms of any exceptional relief should be developed as its experience with area regulation lengthens. Moreover, area regulation of producer prices is avowedly still experimental in its terms and uncertain in its ultimate consequence; it is entirely possible that the Commission may later find that its area rate structure for the Permian Basin requires significant modification. We cannot now hold that, in these circumstances, the Commission's broad guarantees of special relief were inadequate or excessively imprecise. (Footnotes omitted).

36. The express purpose of this rulemaking is to provide an alternate procedural framework for producer rate regulation which will stimulate and accelerate domestic exploration and development of natural gas reserves. That some modification is

necessary and required under the present circumstances of a serious shortage of natural gas can no longer be denied. *Public Service Commission of the State of New York* v. *F.P.C.*, CADC, No. 71-1161, decided March 29, 1972; *Louisiana Power & Light Co.* v. *United Gas Pipe Line Co.*, CA5, No. 71-2550, decided January 14, 1972; *F.P.C.* v. *Louisiana Power & Light Co.*, ____ U.S. ____ (decided June 7, 1972); *Southern Louisiana Area Rate Cases* (*Austral Oil Co.* v. *F.P.C.*) 428 F.2d 407 (CA5, 1970); *Hunt Oil Co.* v. *F.P.C., supra.*

37. Of particular significance to the instant proceedings is the District of Columbia Circuit's recent opinion in *Public Service Commission for the State of New York* v. *F.P.C., supra.* In approving the Commission's rule, that a pipeline's advance payments to producers for gas to be delivered at a future date may be included in the pipeline's rate base, the Court stated (Slip op. at 12):

> It appears to us that what the FPC is attempting to do in this area is to reach an accommodation of conflicting interests, through experimentation, that will result in the proper alleviation of the gas shortage. In doing so, we think that the FPC is making policy decisions of the type it was created to make, and we are reluctant to disturb them. In this very difficult area of rate-making, when it is uncertain what will be the ultimate agency determination, and when it is as yet unknown what will be the results and ramifications of the experimental policies adopted by the agency, we feel that the FPC has demonstrated, as adequately as can be expected under the circumstances, the basis for its actions, and we may thus defer to the expertise of the FPC in this matter. (Footnotes ommitted).

38. Finally, as the Supreme Court said in *Permian* (390 U.S., at 790):

> We must reiterate that the breadth and complexity of the Commission's responsibilities demand that it be

given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties.

39. Our action in establishing a procedural framework for Commission action in the field of certificate and rate regulation is taken under our general power of rulemaking as bestowed by §553 of the Administrative Procedure Act and Section 16 of the Natural Gas Act. Our general statement of policy, and rules of agency procedure and practice here adopted, are not subject to requirements of notice and hearing. §553(b). In recognition of the significance of the matters here dealt with, however, we sought public comment, thereby providing a hearing, within the meaning of §553(c) of the Administrative Procedure Act.

40. Certain comments filed in opposition to this rulemaking suggest that the Commission is abdicating its ratemaking responsibility by permitting producers and purchasers to set rates by private bargain. Such is not the case. Our actions in individual proceedings arising under these new procedures will answer this objection. We will be, as we should be, judged on the proper discharge of our duties on the record made before us in each case.

41. We are firm in our conviction that we must act in an attempt to alleviate the nation's shortage of natural gas supply, and we believe our action herein to be a reasonable and appropriate measure toward that end. We are mindful that any rate or rates we may find proper under the alternative method of certification we provide for herein will be binding subject only to subsequent findings and determinations that may be made under Section 5(a) of the Act, *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 344. Contracts approved unconditionally pursuant to the alternative procedure will be free from any later attempt to impose a refund obligation. We believe that such an assurance is an alternative that must be made available, subject to the conditions we attach thereto.

## ANALYSIS OF RULE

42. As we stated in the Notice, issued April 6, 1972, the rule we adopt hereby will not supersede the procedures that have been promulgated in our various rate opinion and orders nor supplant the procedures set forth in Docket Nos. R-389 and R-389A, but will supplement the procedures set forth in Order No. 431, Docket No. R-418, issued April 21, 1971.

43. Further, the optional procedure will not affect any certificate proceeding which has been completed or is now pending under procedures set forth in the various rate opinions and orders, or under Order Nos. 402, 402A, 431 or our Regulations 157.22 and 157.29.

## COMMENTS AND SUGGESTIONS

44. We shall not attempt to enumerate or discuss each comment received or suggestion made about the proposed new Section 2.75 of the Commission's General Policy and Interpretations, but shall set forth the comments generally, and our conclusions as to them. Our discussion of the lawfulness of our action herein dispenses with any need of discussing the comments made in regard to paragraph "a" of the new Section 2.75.

45. *Paragraph 10.b. (1)* – The question asked here concerned clarification as to whether acreage dedicated to an existing contract under an amendment dated on or after April 6, 1972, would be eligible for certification under the optional procedure. Because of the questions asked, it has become apparent that there is some misunderstanding of our intent to apply the optional procedure to supplies of gas not available to the interstate market prior to April 6, 1972. We seek new supplies of gas, whether such new supplies come from new acreage dedications, or from newly drilled wells, or by diversion from other uses. Accordingly, we clarify paragraph 10b.(1) to make it read:

> A contract covering the sale of natural gas in interstate commerce has been executed for gas produced from a well or wells commenced after April 6, 1972; *or* a contract covering the sale of natural gas in interstate commerce has been executed for gas not pre-

> viously sold in interstate commerce except under the provisions of Orders 402, 418 or 431 issued May 6, and December 10, 1970; April 15, 1971, respectively.

This modification will encourage full development of acreage previously dedicated to the interstate market, as well as encouraging exploration for new reserves. We conclude that expansion of incentives to include all wells commenced after April 6, 1972, the date of our original notice, will greatly encourage additional drilling; to the extent that we bring about additional drilling and production we are securing for the consumer reliable gas supplies not previously deliverable.

In recognizing that prior Commission procedures and policies, which defined the dichotomy between "new" gas and "old" gas on the basis of contract date, have failed to achieve full development of dedicated acreage, we do not intend, nor shall this statement be construed as a release of any dedicated acreage from commitment to the interstate market. Applications tendered under this Section covering gas produced from new wells on old acreage shall be treated as an application for certificate amendment and a Section 4 rate increase filing.

46. *Paragraph 10.b. (2).* – The comments received requested clarification of the term "All Parties." Some requested that "Signatory parties" be substituted for the words "all parties." However, to limit the obligation to parties who sign the sales contract would establish a loophole where working interest owners by merely declining to sign the sales contract, under which their gas is sold, would be able to obtain all the advantages of the optional procedure for the particular sale without giving up any of the advantages the area rate ceilings would afford them under their existing contracts.

47. Therefore, we shall not restrict the requirement that all parties to the contract, except for parties sharing a royalty interest only, agree. The following revised paragraph shall be adopted:

> All parties whose gas is to be sold under the terms and conditions of such contract, except for

> the royalty interest therein, must agree to the submission of the same for certification in accord with the provision of this Section.

48. *Paragraph 10.b. (3).* – In regard to this provision, all of the comments received opposed the 12-year deliverability life requirement because it is alleged the requirement too burdensome and unnecessary. We agree that the 12-year deliverability requirement should be deleted and shall adopt the following language:

> The purchaser under such a contract is a jurisdictional pipeline.

49. *Paragraph 10.b. (4).* – Of the comments received pertaining to this paragraph, the majority requested clarification of the phrase "all obligations." We believe clarification is necessary, and we shall adopt the following language:

> The seller under such contract establishes that he has discharged, or is prepared by an acceptable plan or program to discharge, refund obligations prescribed by prior orders or opinions of this Commission. It is provided, however, that any such seller may make the showing here required without prejudice to his claim in any case now pending on judicial review that such obligations were unlawfully imposed by the Commission.

50. Some of the respondents asked if the optional procedure is available to affiliate or subsidiary off-system and on-system sales. We have no intent to exclude such sales. However, we should point out that such sales will be examined by the Commission to assure that the proposed rates are reasonable and in the public interest.

51. Some question was raised as to whether small producers are eligible for certification under the optional procedure? Here again we had no intent to exclude small producers and we see no reason to do so.

52. *Paragraph 10.b. (5).* – The major problem the parties raised with this paragraph is that clarification is neces-

sary. We agree. The following language will, we believe, clarify the paragraph and remain consistent with our amended wording of paragraph 10.b.(1).

> The gas covered by the contract offered for certification is produced from a well or wells commenced on or after April 6, 1972; or the gas offered for certification has not been previously sold in the interstate market (unless abandonment has been previously granted or a sale was made under Orders 402, 418 or 431), nor has an application been previously filed with the Commission for certification of the sale of such gas, except for an emergency sale under Orders 402, 418 or 431.

53. Other questions were raised in regard to paragraph 10.b. First, will the reserves dedicated under the optional procedure count toward discharge of refund obligations under area rate opinions providing for the same? The answer to that question is no. Provisions for the discharge of refund obligations are components of area rate decisions which are still pending on appeal.

54. Second, would gas flowing under warranty contracts qualify hereunder? The succinct answer here is: No. Opening the optional procedure to warranty gas would necessarily involve the Commission in modification of the terms of the warranty.

55. *Paragraph 10.c.* – Two basic points were raised in reference to this paragraph. First, how can the seller certify to conditions relating to the purchaser? The answer is that the seller does not have to certify to any conditions relating to the purchaser. Such certification is the sole responsibility of the purchaser.

56. Second, replies requested clarification of the term "all parties" in the second sentence. The words "all parties" in the second sentence will be qualified by the inclusion of the phase "except those having a royalty interest only", to conform with the change heretofore noted in paragraph 10.b.(2). Additionally to assist in the clarification of the first

question, the following language for the second sentence will be adopted.

> .... *Each party* to the application shall certify to his portion that all parties to the contract desire certification ...

57. *Paragraph 10.d.* – The parties asked here (a) if individual company rate cases, all Commission actions, and orders be included under this provision; and (b) would rates established under the optional procedure be recognized by the Commission as a basis for triggering price escalation clauses?

58. In answer to the above questions, and to clarify the provision, we shall adopt the following language:

> A certificate of public convenience and necessity issued and accepted under this Section shall not be subject to change by determinations or orders whether heretofore made or hereafter to be made in producer or pipeline rate proceedings initiated under Section 4 of the Act, and orders issued hereunder shall not constitute establishment of an area rate; provided, however, that nothing herein shall limit the applicability of Section 5 of the Natural Gas Act. Nothing done hereunder shall be recognized by the Commission as triggering any existing contract escalation clauses.

59. *Paragraph 10.e.* – The only major substantive question raised by the parties here was whether short-term contracts would be accepted under this rulemaking. We see no reason to provide that only long-term contracts should be permitted under the optional procedure.

60. *Paragraph 10.f.* – Many comments were received relating to this paragraph requesting clarification of the phrase: "indefinite pricing clauses." Many specifically asked if area rate, Btu, tax reimbursement, compression and dehydration, and redetermination and renegotiation clauses would be allowed.

61. We have determined that so-called "area rate clauses" should not be allowed because area ceiling rates might then become a floor for all future contracts to be certificated under the optional procedure. Further, redetermination and renegotiation clauses will not be permitted because rates under the optional procedure would, perforce, be continually changing. Other types of clauses should be allowed, and, therefore, the following language is adopted.

> No contract shall be accepted for filing if it includes any type of indefinite pricing clause except Btu price adjustment clauses, clauses to reflect changes in state production taxes, and clauses allowing for the recovery of compression and dehydration charges. Indefinite pricing clauses shall include, but are not limited to "area rate or FPC clauses", a "price redetermination or renegotiation clause" or a "special escalation clause."

62. *Paragraph 10.g.* – Certain comments were based on a request that some clarification of the type and nature of factual support was necessary in light of paragraph 2 through 7 of the rulemaking procedure.

63. We believe that each contract filed under the alternative procedures must be considered on the merits of the terms and provisions within each contract. There certainly must be some evidentiary basis proffered by the seller-applicant upon which we can judge whether the contract rate is just and reasonable. We will, absent a showing of special circumstance, accept as conclusive the cost findings embodied in our area rate decisions, as such may be supplemented from time to time by appropriate Commission order.

64. *Paragraph 10.h.* – Most of the comments in regard to this section were made as if Paragraph 10.i. were not proposed. We belive that most of the objections would not have occurred if paragraph 10.i. had been read closely. However, even if the information required in this paragraph is not on file with the Commission so that it may be submitted by incorporation, we believe the data will be necessary to properly judge the merits of the contract, and to make a

determination of the propriety of the contract rate. Therefore, we shall make no change in this paragraph.

65. *Paragraph 10.k.* – One party filed a comment stating that the standards were not spelled out as to when the Commission would hold a formal hearing. It is impossible at this time to set such specific standards, or to foresee when possible circumstances surrounding future filings may require a formal hearing. Therefore no change in this provision will be made.

66. *Paragraph 10.l.* – One comment was filed in regard to this paragraph asking whether filing under the alternative procedure imputes any implied waiver by the applicants thereunder. Where the waiver of any right may be provided for herein, it is an express waiver. To eliminate any doubt in the rule itself, however, we shall amend this provision to read:

> 1. A final order of this Commission, issuing a certificate as applied for, or issuing a conditioned certificate acceptable to the applicants, shall constitute a final determination that the rates, charges and services therein specified are just, reasonable and required by the present and future public convenience and necessity.

67. *Paragraph 10.m.(2)* – Virtually all the comments received on this waiver of contingent escalations were firmly opposed and sought elimination of this condition. We are impelled to retain this requirement, with one modification. We strike the phrase "or hereafter issued", thus limiting the waiver to contingent escalations provided for in Opinions 595 (Texas Gulf Coast) and 598 (Southern Louisiana). Thus, only producers with flowing gas production in Southern Louisiana or Texas Gulf are affected by paragraph 10.m.(2).

68. Our reasons for imposing the conditions are twofold: First, contingent escalations are a component of area rates. Flowing and new gas prices were established in Southern Louisiana and Texas Gulf Coast with due regard to the incentives which these escalations provided. Both Southern Louisiana and Texas Gulf Coast (our only opinions which

establish contingent escalations) are on appeal.

69. Secondly, but of equal importance, we offer the procedures herein adopted as an optional procedure to function in parallel with area rate regulation. Were we to cast aside the waiver required in paragraph 10.m.(2), consumers would be injured, and producers in Southern Louisiana and in Texas Gulf Coast (the only producers affected by this waiver) would be afforded an unfair position over producers in all other areas. Such unacceptable results would occur because applications under this Section would operate, in the absence of paragraph 10.m.(2), not only on new gas sales but would also operate to escalate old gas prices as well.

70. By retaining paragraph 10.m.(2) we require, in effect, an election by producers with flowing gas in Southern Louisiana and Texas Gulf Coast; they must choose whether contingent escalations on flowing gas provide a sufficient incentive to seek and sell new gas to the interstate market, at area rates, or whether a greater degree of market freedom in the pricing of new supplies offsets the benefit of contingent escalation of flowing gas prices. Requiring this election protects the consumer, as we must, from escalation of both flowing and new gas rates.

71. We cannot, in equity, permit a producer with flowing gas in Southern Louisiana or Texas Gulf to achieve higher-than-area rate prices for its own new deliveries and still receive price escalations on its flowing gas through the efforts of other producers who elect to remain on area rate pricing for new dedications.

72. The election here required is to be made on a company-by-company basis, with each company's decision to waive Southern Louisiana or Texas Gulf contingent escalations evidenced by the company's acceptance of its first permanent certificate issued under Section 2.75.

73. We emphasize that paragraph 10.m.(2) operates on an area-by-area basis. For example, a producer with flowing gas in Southern Louisiana can use the optional procedures for new gas from any other area without waiving his Southern

Louisiana contingent escalations. Accordingly, while we recognize that paragraph 10.m.(2) may impose a restraint on some producers, under some circumstances, the restraint is necessary and, we believe, required by the public interest.

74. Reserves dedicated hereunder will be allowed to count toward the contingent escalation of flowing gas rates of all other producers operating in the area, if such reserves otherwise qualify for escalation credit under the express terms of Opinions 595 and 598. This is because escalation of flowing gas rates are an industry endeavor in each area where contingent escalations are provided for and is not the function of the discharge of an obligation of any one particular company.

75. We emphasize also that with the exception of the one-time election required by paragraph 10.m.(2), the option between area rate pricing and certification under Section 2.75 procedures here provided lies with the producers on a contract-by-contract basis.

76. *Paragraph 10.n.* – The comments received regarding this paragraph concerned the apparent inconsistency regarding notice to the Commission provided for in the first two sentences. The comments are well-taken. The words: "after notice to the Commission" will be stricken from the first sentence, and the second sentence will be changed to read:

> Notice of commencement of deliveries shall be given to the Commission within ten days after deliveries first commence, and shall include all pertinent information concerning the deliveries.

77. *Paragraph 10.o.*–Many comments filed in regard to this provision objected to the area ceiling rate limitation for the period of six months after deliveries are commenced in accordance with Paragraph 10.n. Such a limitation is, however a reasonable one, since predicated on the assumption that the Commission will have acted by final order within that period of time. The parties may, after the six-month period and upon the filing of a notice of change in rate by the seller, continue the service at the rates specified in the contract,

without refund obligation. Six months is clearly an adequate period for preliminary Staff analysis and review of applications tendered under the optional procedure. Accordingly, by action to deny or condition certificates prior to the expiration of the six-month period, we can protect against the impact of a nonrefundable rate which is not just and reasonable. To clarify that which has appeared to concern many of those responding to this provision, we shall provide that it will be changed to read:

> . . . (If the Commission has not made its final order), the seller upon the filing of a notice of change in rate pursuant to Section 154.94 of the Commission's Regulations shall be entitled to receive without refund obligation and the purchaser shall be entitled to pay, the rates specified in the contract. . .

78. *Paragraph 11.*—A comment was received suggesting that in view of the Commission's intent, stated in the last sentence of the paragraph, to encourage long term, large volume dedications of new supplies of natural gas, the Commission should not accept contracts for less than a minimum term of twenty years. Although it is true that the desired goal of the optional procedure is to obtain long term commitments of gas, we do not believe that contracts for less than twenty years, or life of lease contracts, should be barred. Our consideration of individual applications will reflect due concern for the desirability of long-term dedications.

## GENERAL COMMENTS

79. As we have noted above (paragraph 5) natural gas is the cleanest burning, and insofar as is known today, the least polluting of all the fossil fuels. This, of course, is one of the reasons for its present enlarged demand and desirability as a fuel. Indeed, in some of our metropolitan areas, "clean-air" regulations and restrictions have made natural gas not only desirable, but almost a necessity for some commercial and industrial users. The Environmental Protection Agency (EPA) filed its response in this proceeding, stating that in its opinion

the optional procedure we provide for herein will be a major step towards elimination of the gas shortage and the nation's air pollution problem through the addition of new gas reserves.

80. These rules herein adopted are inherently procedural, providing an optional method by which to obtain certification; accordingly, our rulemaking involves no direct impact on the environment (such as construction of facilities would) nor does it indirectly affect the environment through the setting of rates. Questions of environmental concern may be proper at the time of certification, whatever the procedure employed for such certification, but such questions are of no relevance to the establishment of procedural rules.

81. EPA suggests that the pipelines obtaining these additional gas reserves should file volumetric information on the specific end uses to which the gas will be put. This information would be used to insure that the gas would be used to reduce air pollution. EPA recognizes the possiblity that it may become necessary for this Commission to allocate the end use of gas and suggests that the data it proposes could be useful to the Commission in such a program. However, most, if not all the gas obtained through the optional procedure will go to supplying existing customers. At this time, we do not foresee the new and expanded services envisioned by EPA.

*The Commission further finds:*

(1) The notice and opportunity to participate in this proceeding with respect to the matters presently before the Commission through the submission, in writing, of data, views, comments and suggestions in the manner as described above are consistent and in accordance with all procedural requirements therefor as prescribed in Section 553, Title 5 of the United States Code. Since the amendment prescribed here does not prescribe an added duty or restriction, compliance with the effective date requirements of 5 U.S.C. 553(d) is unnecessary.

(2) The amendment of Part 2, General Rules of Practice and Procedure, General Policy and Interpretations, Subchapter

A, Chapter 1, Title 18 of the Code of Federal Regulations, Section 2.75 Optional Procedure for Certificating New Producer Sales of Natural Gas, as herein prescribed, is necessary and appropriate for the administration of the Natural Gas Act.

(3) Since the modifications to the amendments prescribed herein which were not included in the notice of this proceeding are of a minor nature, and are consistent with the prime purpose of the proposed rulemaking herein, further notice thereof is unnecessary.

*The Commission,* acting pursuant to the provisions of the Natural Gas Act, as amended, particularly sections 4, 5, 7 and 16 thereof (52 Stat. 822, 823, 824, 825 and 830; 56 Stat. 83, 84; 61 Stat. 459; 76 Stat. 72, 15 U.S.C. 717c, 717d, 717f, and 717o) *orders:*

(A) part 2 of the Commission's General Rules of Practice and Procedure, General Policy and Interpretations, Subchapter A, Chapter I, Title 18 of the Code of Federal Regulations is amended by adding new Section 2.75, as follows:

2.75 Optional Procedure for Certificating New Producer Sales of Natural Gas

a. Notwithstanding any other provisions in the General Rules of Practice and Procedure of the Federal Power Commission, or the Regulations Under the Natural Gas Act of the Federal Power Commission, applications for certification of future sales of natural gas produced within the United States may, at the option of the signatory parties to sales contracts, be submitted in accordance with the provisions of this Section. The the extent that any Federal Power Commission General Rules of Practice and Procedure or Regulations under the Natural Gas Act are inconsistent herewith, the same are hereby amended to permit the optional procedure herein set forth.

b. The provisions of this Section shall be available if each of the following conditions exists:

1. A contract covering the sale of natural gas in interstate commerce has been executed for gas produced from a well or wells commenced after April 6, 1972; *or* a contract covering the sale of natural gas in interstate commerce has been executed for gas not previously sold in interstate commerce except under the provisions of Orders 402, 418 or 431 issued May 6, and December 10, 1970; April 15, 1971, respectively.

2. All parties whose gas is to be sold under the terms and conditions of such contract, except for the royalty interest therein, must agree to the submission of the same for certification in accord with the provision of this Section.

3. The purchaser under such contract is a jurisdictional pipeline.

4. The seller under such contract establishes that he has discharged, or is prepared by plan or program to discharge, refund obligations prescribed by prior orders or opinionsof this Commission. It is provided, however, that any such seller may make the showing here required without prejudice to his claim in any case now pending on judicial review that such obligations were unlawfully imposed by the Commission.

5. The gas covered by the contract offered for certification is produced from a well or wells commenced on or After April 6, 1972; or the gas offered for certification has not been previously sold in the interstate market (unless abandonment has been previously granted or a sale was made under Orders 402, 418 or 431), nor has an application been previously filed with the Commission for certification of the sale of such gas, except for an emergency sale under Orders 402, 418 or 431.

c. If all of foregoing conditions precedent exist, the parties to the contract may tender the same to the Commission and request the issuance of a certificate of public convenience and necessity to the seller for sales of natural gas thereunder. Each party to the application shall certify to his portion that all parties to the contract, except those having a royalty interest only, desire certification in accordance with the terms and provisions of this Section, that the seller expressly agrees to the waivers and elections hereinafter provided for in subsections m and n of this Section, and that all conditions precedent as set forth in sub-section b of this Section are met.

d. A certificate of public convenience and necessity issued and accepted under this Section shall not be subject to change by determinations or orders whether heretofore made or hereafter to be made in producer or pipeline rate proceedings initiated under Section 4 of the Act, and orders issued hereunder shall not constitute establishment of an area rate; provided, however, that nothing herein shall limit the applicability of Section 5 of the Natural Gas Act. Nothing done hereunder shall be recognized by the Commission as triggering any existing contract escalation clauses.

e. Applications presented hereunder will be considered for permanent certification, either with or without pre-granted abandonment, notwithstanding that the contract rate may be in excess of an area ceiling rate established in a prior opinion or order of this Commission.

f. No contract shall be accepted for filing if it includes any type of indefinite pricing clause except Btu price adjustment clauses, clauses to reflect changes in state production taxes, and clauses allowing for the recovery of compression and dehydration charges. Indefinite pricing clauses shall include,

but are not limited to "area rate or FPC clauses", a "price redetermination or renegotiation clause" or a "special escalation clause."

g. A seller-applicant under this Section shall state the ground for claiming that the present or future public convenience and necessity require issuance of a certificate on the terms proposed in the application, and shall provide factual support for such claims. The application shall contain a contract summary as prescribed in Sec. 250.5 of our Regulations Under the Natural Gas Act.

h. The purchaser under a contract filed under this Section shall certify that the present or future public convenience and necessity require issuance of a certificate to the seller, and shall provide information in support of such certification with respect to the pruchaser's (1) system-wide supply, (2) present and estimated 3-year peak day and average day demands, (3) present and estimated 3-year requirements of customers on its system, (4) deliverability life, (5) implementation, if any of curtailment plans, (6) emergency purchases of gas under Order 431, or 157.22 or 157.29 of these Regulations, and (7) purchases of LNG or attachment of other supplemental supplies.

i. The information required by sub-section g. and h. may be submitted by cross-reference and incorporation of information already on file with the Commission.

j. Applications requesting issuance of certificates of public convenience and necessity as authorized in this Section shall be processed in accordance with the procedural requirements, including those relating to notice, intervention and hearing, set out in Part 157 of the Commission's Regulations Under the Natural Gas Act.

k. Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Power Commission by Sections 7 and 15 of the Natural Gas Act and the Commission's Rules of Practice and Procedure, a statutory hearing will be held before the Commission without futther notice on all applications for certificates under this Section in which no petition to intervene in opposition is filed within the time required, if the Commission on its own review of the matter believes that a grant of a certificate is required by the public convenience and necessity. Where the Commission believes that a formal hearing is required notice of such hearing will be duly given.

l. A final order of this Commission, issuing a certificate as applied for, or issuing a conditioned certificate acceptable to the applicants, shall constitute a final determination that the rates, charges and services therein specified are just, reasonable and required by the present and future public convenience and necessity.

m. By acceptance of a certificate issued hereunder, the seller-applicant unconditionally agrees to (1) waive all rights to seek future rate increases under Section 4 of the Natural Gas Act with respect to the contract submitted, other than price escalations, if any, as certificated by the Commission; and (2) waive all rights to contingent adjustment of flowing gas rates as provided by the Commission in area rate decisions heretofore decided, for flowing gas which the seller-applicant produces in the same geographical pricing area as the pricing area of the production covered by the application made under this Section.

n. Upon the filing of an application under this Section, deliveries pursuant to the provisions of the tendered contract may be commenced, pending review of such application by the Commission.

Notice of commencement of deliveries shall be given to the Commission within ten days after deliveries first commence, and shall include all pertinent information concerning the deliveries. Any such deliveries so commenced may be terminated (1) if such contract for any reason shall terminate or be terminated prior to the issuance by the Commission of a final order upon review of such application, or (2) upon the issuance of a certificate containing conditions unacceptable to the party adversely affected. If the Commission by final order shall deny such application, or if the party or parties to the contract adversely affected shall not accept the terms and conditions prescribed by the Commission, deliveries thereunder shall be terminated. Within thirty days after termination of deliveries, the seller shall notify the Commission of such termination, and shall report the date of termination, volumes delivered, and revenues received.

o. If the parties elect to commence deliveries as set forth in subsection n., such deliveries will be made at rates no higher than the prevailing area ceiling rate and shall so continue for six months unless the Commission has made its final orders on the application at an earlier date; at the end of such six-month period (if the Commission has not made its final order), the seller upon the filing of a notice of change in rate pursuant to Section 154.94 of the Commission's Regulations shall be entitled to receive without refund obligations and the purchaser shall be entitled to pay, the rates specified in the contract, and such contract rates shall continue as the effective rates until the Commission enters its final order on the certificate application.

(B) The amendment provided for herein shall be effective as of the date of issuance of this order.

(C) The Secretary of the Commission shall cause prompt publication of this order to be made in the Federal Register.

By the Commission.

(S E A L)

Mary B. Kidd,
Acting Secretary

## DOCKET NO. R-441

## RESPONDENTS TO OPTIONAL PROCEDURE

### Independent Producers

Amoco Production Company
Atlantic Richfield Company
Aztec Oil and Gas Company
Perry R. Bass
California Company, Division of Chevron
Cities Service Oil Company
Estate of E. Cockrell Jr.
Continental Oil Company
Exchange Oil and Gas Corporation
James Forgotson, Sr.
General American Oil Company of Texas
GHK Corporation
Gulf Oil Corporation
Humble Oil and Refining Company
Inexco Oil Company
Kansas Natural Gas, Inc.
Kerr-McGee Corporation
Lake Washington, Inc., U.S. Oil of Louisiana, Inc.
Marathon Oil Company
Mesa Petroleum Company
Mobil Oil Corporation
Phillips Petroleum Company
Joint Comments & Suggestions of Twelve Company Producer Group
Shell Oil Company
Sun Oil Company
Superior Oil Company
Tenneco Oil Company
Texaco, Inc.
Texas Pacific Oil Company, Inc.
Union Drilling, Inc.
Union Oil of California

### Pipeline Companies and Pipeline Groups

American Natural Gas System
Colorado Interstate Gas Company
Columbia Gas System Service Corporation

**Consolidated Gas Supply Corporation**
**El Paso Natural Gas Company**
**Iroquois Gas Corporation**
**Natural Gas Pipeline Company of America, (Peoples Gas Light & Coke and North Shore Gas Company)**
**Northern Natural Gas Company**
**Pacific Gas Transmission Company**
**Panhandle Eastern Pipeline Company**
**Southern Natural Gas Company**
**Southern Union Gas Company**
**Tennessee Gas Pipeline Company**
**Transcontinental Gas Pipeline Corporation**
**United Gas Pipeline Company**
**United Natural Gas Company**
**Pennsylvania Gas Company**

## Distribution Co's and Distribution Groups

**Associated Gas Distributors (AGD)**
**Boston Gas Company, et al. (16 Co's.)**
**California Distributor Group**
**Central Illinois Public Service Company**
**Consumers Power Company**
**Illinois Power Company**
**Long Island Lighting Company**
**Northern Illinois Gas Company**

## State Commission's, Cities and Municipalities

**Public Service Commission of Missouri**
**State of California and PUC of California**
**City of Chicago**
**Citizens Gas and Coke Utility (City of Indianapolis)**
**State of Indiana, Public Service Commission**
**State of Kansas Corporation Commission**
**Memphis Light, Gas and Water Division (City of Memphis)**
**State of New Mexico**
**Public Service Commission of New York**
**North Carolina Utilities Commission**
**Salt River Project Agricultural Improvement & Power District**

## Congressional and Governmental Agencies

**Bill Archer, Congressman, Texas**
**Lloyd M. Bentsen, Senator, Texas**

Department of Commerce
Congress of the United States, Joint Economic Committee
Concerned Congressmen (21 Members)

Congressman John E. Moss
Congressman John D. Dingell
Congressman Ogden R. Reid
Congresswoman Bella S. Abzug
Congressman Joseph P. Addabbo
Congressman Herman Badillo
Congressman Jonathan B. Bingham
Congressman Silvio O. Conte
Congressman Jerome R. Waldie
Congressman Charles C. Diggs, Jr.
Congressman Thaddeus J. Dulski
Congressman Thaddeus J. Dulski
Congressman William D. Ford
Congressman Seymour Halpern
Congressman Robert L. Leggett
Congressman Thomas M. Rees
Congressman Benjamin S. Rosenthal
Congressman Charles A. Vanik
Congressman Phillip Burton
Congressman Bertram L. Podell
Congressman Lionel Van Deerlin
Congressman George E. Danielson
Marlow W. Cook, Senator, Kentucky
William P. Curlin, Jr., Congressman, Kentucky
Environmental Protection Agency
Philip A. Hart, Senator, Michigan
Department of Interior
Walter Jones, Congressman, North Carolina
Warren G. Magnuson, Senator, Washington
Wilmer D. Mizell, Congressman, North Carolina
Neal Smith, Iowa, and Silvio O. Conte, Massachusetts, Congressmen

### Trade and Consumer Groups

American Public Gas Association, American Public Power Association and Consumer Federation of America
Consumers Assembly of Greater New York
Gas Appliance Manufacturers Association
Independent Natural Gas Association of America (INGAA)
Independent Petroleum Association of America (IPAA)

Institute for Public Interest Representation (S.O.U.P.)
Kansas Municipal Utilities, Inc.
Public Interest Research Group

**Other**

Hamilton Treadway
Anthony R. Martin–Trigona (P.O.W.E.R.)
Midrex Division (Midland-Ross Corporation)
Natural Resources Defense Council, Inc. (Environmental Group)

## APPENDIX B

## UNITED STATES OF AMERICA
## FEDERAL POWER COMMISSION

(18 CFR 2.75)

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Pinkney Walker,
and Rush Moody, Jr.

Optional Procedure for Certificating ) Docket No. R-441
New Producer Sales of Natural Gas)

## ORDER NO. 455-A

## ORDER CLARIFYING ORDER, AND DENYING APPLICATIONS FOR REHEARING AND STAY

(Issued September 8, 1972)

American Public Gas Association, American Public Power Association and Consumer Federation of America (the Associations) jointly filed on August 10, 1972, an application for rehearing of the Commission's Order No. 455, Optional Procedure for Certificating New Producer Sales of Natural Gas, Docket No. R-441, issued August 3, 1972 (37 F.R. 16188, 8/11/72. Gulf Oil Corporation (Gulf) similarly filed on August 23, 1972, an application for rehearing of said Order and also requested clarification of the Order with respect to warrantly contract sales. On August 29, 1972, twenty-one "Concerned Congressmen" (Congressmen) filed an application for rehearing and motion for stay of the Order. On September 1, Texaco Inc. filed its motion for reconsidera-

tion,[1] and on September 5, 1972, the Public Service Commission for the State of New York, Continental Oil Company, Amoco Production Company, and Phillips Petroleum Co., each filed a petition for rehearing of said Order.[2] We shall discuss the applications for rehearing, motions for clarification, and motions for stay separately, except in such instances as the applicants may have raised the same point.

At the outset, the Associations and "Concerned Congressmen" contend (1) we are without authority to promulgate Order No. 455, and (2) Order No. 455 amounts to deregulation. Our authority to issue Order No. 455 emanates from Congressional delegation of such authority in the Natural Gas Act, as well as the procedural mandates of the Administrative Procedure Act, and the judicial precedents interpreting such statutes. In Order No. 455, we set forth with specificity both our authority to promulgate such a policy statement and the judicial support for the procedures which were adopted (pp. 12-16). In fact, in order to afford the widest public participation possible, we followed the traditional rulemaking procedures–something which we need not have done for a policy statement.

The irrefutable fact is that this Nation is confronted with an energy crisis, and more particularly, a gas shortage. This Commission has used the breadth of its authority to deal with the problems which had arisen over the last decade. This Commission has the flexibility to adapt its policies to changing circumstances[3] and by issuing Order No. 455, we have carried forth our responsibilities as delegated to us by the Congress.

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[1]On September 5, 1972, Amerada-Hess filed a telegraphic joinder in Texaco's petition.

[2]Superior Oil Co. filed a motion for reconsideration on September 7, 1972, and the issues raised in that motion shall be discussed here.

[3]*Permian, infra* at 800, 816 n. 99; *Wisconsin* v. *F.P.C.*, 373 U.S. 294, 309 (1963); *F.P.C.* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

The "Concerned Congressmen" and Associations contend we erred in adopting Order No. 455 without a full trial-type hearing. There is no statutory requirement requiring a full evidentiary hearing prior to the issuance of a policy statement.[4] We issued a notice of our proposed rule and solicited written comments from all interested parties. This is the only "hearing" required when an agency proceeds under its informal rulemaking authority.[5] We reiterate that no rates have been prescribed by Order No. 455[6] and that individual hearings will be held on each certificate application so filed at which time any interested party, including petitioners, may intervene and present evidence.[7]

It has been contended that we have deregulated natural gas producers by issuing Order No. 455. The scope of our policy statement is limited to gas produced from a well or wells commenced after April 6, 1972, or gas not previously sold in interstate commerce except under the provisions of Order Nos. 402, 418 or 431. The area rate framework, initiated in 1960, and completed for all major producing areas except Rocky Mountain, is unaffected by Order No. 455. We

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[4]See *U.S.* v. *Allegheny-Ludlum Steel Corp.*, 32 L.Ed. 2d 453, 464-5 (1972); *Siegel* v. *A.E.C.*, 400 F.2d 778 (CADC, 1968); *Pacific Coast European Conference* v. *U.S.*, 350 F.2d 197 (CA 9), cert. denied 382 U.S. 958 (1965); *Long Island RR Co.* v. *U.S.*, 318 F. *Supp.* 490 (E.D.N.Y. 1970); Attorney General's Manual on the Administrative Procedure Act (1947) at p. 78.

[5]Ibid.

[6]APGA argues we have retroactively set rates. Initially, no rates have been prescribed by Order No. 455. Further, rules which affect existing rights have been upheld on numerous occasions. E.g., *WBEN, Inc.* v. *U.S.* 396 F.2d 601, 609, 618, 622 (CA2), cert. denied 393 U.S. 914 (1968); *Air Line Pilots Assn., Int.* v. *Quesada*, 276 F.2d 892, 896 (CA2, 1960), cert. denied 366 U.S. 962 (1961).

[7]*P.S.C. of N.Y.* v. *F.P.C.*, CADC, No. 71-1161, March 29, 1972, Slip op. at 13. Compare *Wisconsin* v. *F.P.C.* 292 F.2d 753 (CADC, 1961); *Wisconsin* v. *F.P.C.*, 303 F.2d 380, 387 (CADC, 1961), affirmed 373 U.S. 294 (1963).

have provided an optional procedure for certificating new gas sales. Contrary to the "Concerned Congressmen's" contention, this procedure is not without standards. Certification will be subject to the standards of "just and reasonable" in Section 4 and "present and future public convenience and necessity" of Section 7. We will apply those standards of the Natural Gas Act as interpreted by the courts. In other words, only after a hearing, and Commission findings, subject to Sections 4 and 7, will such a certificate be granted. This is not decontrol. It is the "end result" of our actions which must be judged,[8] and if Order No. 455 assists in alleviating the gas shortage, this Commission is fulfilling its obligations under the Natural Gas Act.

The Associations contend that the optional procedure as promulgated in Section 2.75 of the Commission's General Rules of Practice and Procedure, General Policy and Interpretations, exempt new gas sales from the requirements that the rates and charges therefor be just and reasonable. Such a contention is without merit. Section 2.75 1 specifically states that the rates, charges and services to be certificated under the optional procedure shall be just and resonable and required by the present and future public convenience and necessity. In other words, such certification shall conform to the standards of Sections 4 and 7 of the Natural Gas Act.

The second contention of the Associations that the major premise of the optional procedure is to set natural gas rates for new sales solely upon "market conditions" is similarly without merit. This contention is made without regard or recognition of the evidentiary burden imposed upon a seller-applicant by Section 2.75 g, and upon the purchaser by Section 2.75 h. We are not foreclosed from considering "market conditions" any more than we are prohibited from considering "non-cost" factors in an area rate proceeding.

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[8]*F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); *Colorado Interstate Gas Co. v. F.P.C.*, 324 U.S. 581, 625 (1945).

*Permian Basin Area Rate Cases*, 390 U.S. 747, 791, 795, 815 (1968); *Austral Oil Co.* v. *F.P.C.*, 428 F.2d 407, 426, 441 (CA5, 1971). Indeed, to ignore such conditions would be to act contrary to the Fifth Circuit's mandate that we must consider market conditions and the industry's capital requirements to meet the consumer needs for reliable and adequate gas service. Id. 428 F.2d at 435, 433-4. We would be derelict in our responsibilities if we did not consider the intrastate market prices and the ability of interstate pipelines to obtain the necessary gas reserves to meet the needs of jurisdictional customers. Order No. 455 represents another step in this Commission's efforts to deal with the gas shortage, and as such, is experimental in the same context as our advance payments policy (See Order No. 455 at pp. 14-15). So too was the initiation of producer area rates experimental in the 1960's and the Supreme Court clearly recognized that we may develop more effective regulatory tools. *Permian, supra* at 772 n. 37, 790, 800. Our action here is, of course, an optional procedure, and while not replacing area rates, we reject the idea that area rates is the *only* method by which producer rates can be determined.

"Concerned Congressmen" indicate our actions will be futile because we erred in not estimating the additional forthcoming new gas reserves. The short answer is that there will be no certificates issued pursuant to Section 2.75 of our Regulations except when the gas so applied for is dedicated to the jurisdictional market. In other words, in each individual certificate hearing, we will know what volumes of gas reserves will be dedicated, prior to the issuance of a certificate.

The Associations contend there is no gas supply shortage. Counsel for APGA's arguments have been rejected by two United States Courts of Appeals[9] and the gas shortage has been recongized by the United States Supreme Court.[10]

[9]*The People of the State of California* v. *F.P.C.*, CA9, No. 71-1036, July 31, 1972, Slip op. at 20-22; *City of Chicago* v. *F.P.C.*, 458 F.2d 731, 747-9 (CADC, 1971), cert. denied 405 U.S. 1074 (1972).

[10]*F.P.C.* v. *Louisiana Power & Light Co.*, No. 71-1016, S.Ct., June 7, 1972, Slip op. at 4.

Counsel for the Associations would have this Commission ignore the curtailments of firm gas customers by seven major interstate pipelines have now filed curtailment plans. Firm requirement deficiencies during the 1972-1973 heating season are expected to be even more severe.[11] In other words, new customers are being denied gas service and the service to existing customers is being reduced. The salient fact is that there is a shortage in deliverable gas reserves contrary to the national interest.

Counsel for Association contend we have "denied the consumers of a right to a hearing on the record of the facts relating to the shortage issue." Counsel, representing the American Public Gas Association, advanced similar arguments in the Rocky Mountain proceeding, involving initial rates and has sought court review and in the Hugoton-Anadarko area rate case.[12] In the latter case, the Ninth Circuit, in affirming the Commission's orders in full, rejected the Association's arguments. *People of State of California, supra.* In each of these proceedings, among others, counsel had a "right to a hearing on the record of the facts relating to the shortage issue." Other parties representing consumer interests and the Commission staff also participated in those proceedings. In each case, based upon a full evidentiary record, the Commission determined there was a gas shortage. While we will continue to provide a forum for counsel, inasmuch as the disappointed litigant has not submitted any evidence in this proceeding through written comments, we will reject his unsupported allegations. However, in any certificate proceeding, counsel may, of course, submit such evidence at a public hearing, including that related to the "shortage issue."[13]

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[11]Date a filed with the FPC by 15 pipelines indicate projected deficiencies of 1 trillion cubic feet or almost 10 percent of those pipelines' annual gas sales.

[12]Counsel advanced the same arguments on behalf of the Municipal Distributors Group in the Southern Louisiana area rate proceeding which is presently before the Fifth Circuit for review.

[13]See *City of Chicago, supra*, at 749.

However, in the interim, this Commission will rely, for purposes of determining the gas consumer needs of this Nation, on the *fact* that those needs are not being met. We will continue to rely on evidence of pipeline curtailments, investment in alternate energy sources and supplemental gas supplies, reports of shortages by state commissions, federal resource agencies, in addition to published data concerning exploratory and developmental well activity, the gas reserves of the interstate pipelines as reported to us on Form 15, the Potential Gas Committee, the Future Requirements Committee, Staff Report No. 2 and other relevant data.

"Concerned Congressmen" and Associations contend our action here violates Price Commission Regulations because the price increases are inflationary. The fact is that there are no price increases contemplated under Docket No. R-441 for gas already dedicated to the interstate market, to which an "initial price" will be determined as a condition to the certificate. That "initial price" will represent a just and reasonable determination of the lowest reasonable rate consistent with adequate service. An important policy consideration which we cannot ignore is that because of the gas supply-demand imbalance, unsatisfied gas demands are transferred to higher-priced alternate fuels, which both increases demand and prices for those fuels and in other energy markets, to the detriment of consumers. A continuation of the gas shortfall will likewise serve as a deterrent to economic recovery. Thus, our Order No. 455 balances the objectives of the Natural Gas Act and the Economic Stabilization Act of 1971.

"Concerned Congressmen" urge this Commission to recommend accelerated leasing of federal domain lands to the Department of Interior. As a matter of policy, we have urged, both by letters and other requests, for increased lease sales on federal lands in order to obtain the maximum efficient development of our domestic resource base. This Commission policy recognizes that the development of such resources is responsive to factors other than wellhead prices established by the Federal Power Commission, including *inter alia*, leasing policies on federal domain lands, tax policies, the relative attraction between domestic and foreign investments, and the industry's technological level concerning offshore operations.

The Associations assert that the provision in Section 2.75e for certification with or without pregranted abandonment is contrary to Section 7(b) of the Act. Suffice to say that Section 7(b) requires, *inter alia*, that no natural gas company may abandon jurisdictional service without having first obtained the lawful permission and approval of the Commission that the present or future public convenience and necessity permits such abandonment. Certainly, when an application for pregranted abandonment is before it for determination as to its certification, the Commission may make the necessary findings required by Section 7(b) of the Act.

The Associations alleged that the Commission erred in allowing pipeline-production, including affiliated companies, to utilize the optional procedure because they state "no arms length negotiation over prices exists in such situations." We have not opened Section 2.75 procedures to pipeline production, and as we stated in Order No. 455 (Mimeo. p. 21, par. 63) we will, "absent a showing of special circumstance, accept as conclusive the cost findings embodied in our area rate decisions, as such may be supplemented from time to time by appropriate Commission order." Thus, we can only reiterate that transactions between pipelines and affiliates, or subsidiary off-system sales, will be examined by us to assure that such transactions and "the proposed rates are reasonable and in the public interest." In any event, the fact of whether or not the transaction is conducted at "arms-length" is but one of many to be considered by us in making a just and reasonable determination.

In its request for clarification and reharing, Gulf contends that exclusion of warranty contract sales from the optional certificate procedure of Order No. 455 is unduly discriminatory because, by its terms, it does not apply to such sales from wells commenced after April 6, 1972. The Commission reaffirms its intention to exclude warranty contract sales from the provisions of Order No. 455 because such contracts contemplate additional drilling, if necessary, in fulfillment of the volumetric warranty. Drilling under warranty contracts does not in itself result in increased gas supplies to the interstate market, and, therefore, it follows that sales under

such existing contracts should not be eligible for the optional procedures of Order No. 455.

However, Gulf submits that a producer-seller should have the opportunity to amend its contract to be applicable to gas producer leases acquired, and wells drilled thereon after April 6, 1972, and to be able to demonstrate to the Commission that prices incurred in such acquisitions and drilling are in the public interest. That issue is pending for decision in another proceeding to which Gulf is a party, and we will not rule on that issue here.

The petition for rehearing of the Public Service Commission of the State of New York reiterates the contention made in its comments, filed in response to the notice herein, that we should exclude short-term contracts from certification under the optional procedure. New York in its petition for rehearing sets forth no facts nor does it advance any argument that we did not have before us when we determined not to condition Section 2.75 e so as to exclude such short term contracts. Reconsideration of the matter has not caused us to change our determination. The duration of the contract will be one factor in our determination in the individual certificate proceeding.

Continental suggests that the Commission erred in failing to provide expressly that denial of an application by the Commission, or rejection of a certificate under the optional procedure by a seller, would vitiate and nullify all waivers made by the seller in connection with the application. Had we intended the waiver requirements of 2.75 to apply irrespective of whether certificates ever became effective under 2.75, we would have so stated. It is our intention that the waivers required by Section 2.75m are effective only in the event that the 2.75 application containing the waivers is approved by the Commission and the certificate thereunder accepted by the seller/applicant. If the Commission denies the application, or prescribes conditions which are unacceptable to the seller/applicant, the waivers which were made a part of the application are not binding upon the seller/applicant.

Continental and Texaco request clarification with respect to paragraph b(4) of Section 2.75, asking whether it is necessary for a seller/applicant to show that it has discharged its refund obligations under all prior orders or opinions of this Commission in order to be eligible for presentation of an application. We did not so intend. We require only that a seller/applicant show, with respect to the geographical pricing area in which the prospective seller would commit the gas under the optional procedure, that he has discharged, or is prepared by plan or program to discharge, refund obligations with respect to that geographic area. Thus, if a seller/applicant should owe refunds in Southern Louisiana but not owe refunds in the Texas Gulf Coast Area, the seller/applicant would be able to utilize 2.75 procedures for Texas Gulf Coast Area gas without regard to the status of its refund obligations in Southern Louisiana.

We have also been asked to clarify whether or not contract escalations approved by the Commission in a Section 2.75 proceeding would be self-operative or whether such would necessarily be subject to rate change filings under Section 4(e) of the Natural Gas Act. We believe that this inquiry is answered by *Episcopal Theological Seminary of the Southwest* v. *F.P.C.*, 269 F.2d 228 (CADC), cert. denied *sub nom., Pan American Petroleum Corp.* v. *F.P.C.*, 361 U.S. 895 (1959), wherein it was held that *no* rate change could become effective without a 4(e) filing. This is not to say, however, that the Commission recedes from the basic position expressed in Order No. 455 that it intends to grant sanctity of contract to the full extent that the Commission can, absent amendment of the Natural Gas Act by Congress. It is our intention to consider applications under Section 2.75 and make a one time determination of the public convenience and necessity aspects of the certificate application and the justness and reasonableness of the rates therein proposed, both as to initial rates and as to definite escalations which might be embodied in the contract. For future definite escalations to become effective without a 4(e) filing will require amendment of the Natural Gas Act, through legislation such as that now pending before Congress.

It is most forcefully argued by Continental, Texaco, Phillips and Amoco that we have erred in outlawing certain types of escalation clauses in Section 2.75f and that the prohibitions of subsection f will operate as a disincentive to long-term commitment of natural gas to the interstate market. We are particularly urged to permit the inclusion of so-called "FPC clauses" or "area rate clauses" in contracts tendered for certification under Section 2.75.

If we did not intend to afford sanctity of contract to the fullest extent available to this Commission, we would be inclined toward sympathy with the producers' view. However, we think it inappropriate for us to sanctify a contract in the sense of guaranteeing that the price will not go down but deny the reciprocal sanctity that a certificated contract price will not rise.

We are of the firm opinion that the optional procedure should stand on its own as a means of producer rate regulation, and represent a true option to those buyers and sellers who choose the optional procedure over regulation under the area rate structure. To accept the requests of these applicants would permit them the benefits of the higher price obtainable under either system, a procedure which we decline to adopt.

*The Commission further finds and orders that:*

(1) Except for the clarifications in the order as herein provided, the applications for rehearing, motions for reconsideration, and motions for stay, are denied, inasmuch as no new facts or legal authorities have been presented which would require further modification of Order No. 455.

(2) Section 2.75b.4. is hereby amended to read as follows:

The seller under such contract establishes that he has discharged, or is prepared by plan or program to discharge, refund obligations in the geographical pricing area in which the seller would commit gas under such contract, prescribed by prior orders or opinion of this Commission. It is provided, however,

that any such seller may make the showing here required without prejudice to his claim in any case now pending on judicial review that such obligations were unlawfully imposed by the Commission.

By the Commission.

Kenneth F. Plumb,
Secretary

(S E A L)

Nos. 72-1490 and 72-1491

IN THE

# Supreme Court of the United States

October Term, 1972

FEDERAL POWER COMMISSION, *et al.*, *Petitioners*

v.

TEXACO INC., *et al.*, *Respondents*

**On Petitions For Writs of Certiorari to The United States Court of Appeals For The District of Columbia Circuit**

# BRIEF OF THE RESPONDENT TEXACO INC. IN OPPOSITION

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June 1, 1973

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Nos. 72-1490 and 72-1491

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IN THE

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**On Petitions For Writs of Certiorari to The United States Court of Appeals For The District of Columbia Circuit**

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## BRIEF OF THE RESPONDENT TEXACO INC. IN OPPOSITION

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Texaco Inc. (Texaco), a Respondent in this proceeding, opposes the petitions for writs of certiorari filed by the Solicitor General on behalf of the Federal Power Commission (Commission) in No. 72-1490 and Dudley T. Dougherty, *et al.*, Co-Executors of The Estate of Mrs. James R. Dougherty, *et al.*, in No. 72-1491. Texaco fully supports the concept of deregulation of *all* interstate gas

producer sales in interstate commerce from Commission jurisdiction under the Natural Gas Act (Act). However, this Court's decision in the first *Phillips* case, *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672 (1954), and other legal precedents, lead Texaco to believe that relief from direct rate regulation under the mandatory provisions of Section 4 of the Act of some or all independent gas producers can be granted only by Congress, not the Commission. Additionally, in support of its opposition, Texaco adopts *mutatis mutandis* the brief in opposition of Respondent, Phillips Petroleum Company, filed herein on June 1, 1973. Therefore, Texaco opposes the petitions for writs of certiorari to the United States Court of Appeals for the District of Columbia Circuit filed by Petitioners herein.

Respectfully submitted,

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June 1, 1973

FILE COPY



IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972

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No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner,*

v.

TEXACO INC., ET AL., *Respondents.*

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No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., *Petitioners,*

v.

TEXACO INC., ET AL., *Respondents.*

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**On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## BRIEF IN OPPOSITION FOR RESPONDENT INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

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---

**On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## BRIEF IN OPPOSITION FOR RESPONDENT INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

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The Independent Natural Gas Association of America (INGAA) is a non-profit trade association representing virtually all of the major long-distance natural gas transmission lines (pipelines) in the

United States.[1] INGAA, a petitioner in the court below, opposes the petitions[2] for writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in the above-described proceedings.

## QUESTION PRESENTED

Does the Federal Power Commission (FPC or Commission) have authority to exempt small producers from direct rate regulation under the Natural Gas Act (Act) by shifting the burden of establishing the justness and reasonableness of rates for interstate wholesale sales of natural gas from the sellers (small producers) to the purchasers (interstate pipelines or large producers)[3] despite clear statutory language to the contrary?

## STATEMENT

### A. Proceedings Before the Commission.

On July 23, 1970, the Federal Power Commission issued, in Docket No. R-393, a Notice of Proposed Rulemaking entitled "Exemption of Small Producers

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[1] INGAA's membership also includes producers and distributors of natural gas.

[2] Reference is made herein solely to the petition of the Federal Power Commission, No. 72-1490, inasmuch as Dougherty, *et al.*, No. 72-1491, do not raise any significant points not already covered by FPC.

[3] Large producers often purchase gas from small producers and subsequently resell the gas to interstate pipeline purchasers. We recognize that large producers may thus be aggrieved in somewhat the same manner as are the interstate pipelines by Order Nos. 428 and 428-B, but in this brief, INGAA will restrict its discussion to the impact of the Commission's unlawful action upon its pipeline company members.

from Regulation" (R. 1-13). In essence, the Commission proposed to exempt small producers[4] from rate regulation under the Natural Gas Act, permitting them to collect contractually-negotiated prices for gas sold in interstate commerce for resale. The Commission undertook to assure small producers that their contract price would not be subject to change by the FPC and, therefore, they would no longer be subject to refund obligations. The Commission's stated purpose was to stimulate additional exploratory efforts and dedication of gas reserves to the interstate market in order to augment the dwindling supplies. Its principal asserted authority for such was its classification powers under Section 16 of the Act.

The Commission did not propose to free small producers from all regulation under the Act, however, announcing that it would retain abandonment authority over small producers' sales pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b), as well as requiring certain annual reports. Further, the Commission proposed to allow pipelines to file "tracking" rate increases[5] to recover increases in their purchased gas costs which were anticipated as a result of exempting small producers from rate regulation.

After receiving comments from various parties, the Commission issued Order No. 428 entitled, "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed

[4] "Small producers" are those producers selling 10,000,000 Mcf or less of natural gas in interstate commerce for resale annually.

[5] "Tracking" rate increases authorized by the FPC are similar in concept to the more familiar "fuel adjustment" clauses.

Filing Requirements" (FPC Pet., pp. 29a-46a).[6] The Order, in general, followed the proposal indicated by the Commission's Notice of July 23, 1970 with respect to exempting small producers from rate regulation but, for the first time, the Commission indicated that the pipelines' right to "track" increases in purchased gas costs would be limited to that portion of the contract prices paid to small producers which the Commission, in later proceedings, finds justifiable. The essence of the newly-announced *indirect* scheme of small producer rate regulation is set forth in the following excerpts:

> "The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales *but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers' sales.*" (Emphasis supplied.) (FPC Pet., p. 32a).
>
> * * *
>
> "Any question as to the propriety of the price paid by a pipeline to a small producer *will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified.* The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent." (Emphasis supplied.) (FPC Pet., p. 33a).
>
> * * *
>
> "*Small producers will have no refund obligations* with respect to increased rates . . . However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons

[6] Reference "FPC Pet." is to the Commission's Petition for Writ of Certiorari in No. 72-1490.

with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." (Emphasis supplied.) (FPC Pet., p. 37a).

INGAA and its pipeline members were, theretofore, unaware that the Commission's proposal for deregulation of small producers raised substantial potential adverse impacts upon the pipelines' ability to recover their legitimate expense items of purchased gas, contracted for in good faith efforts to render adequate service to their customers. INGAA, as did certain of its pipeline members, petitioned for rehearing of Order No. 428 and urged the Commission to correct this situation. On July 15, 1971, the Commission issued Order No. 428-B (FPC Pet., pp. 50a-84a), which modified Order No. 428 in certain respects not at issue herein but reasserted the Commission's authority to engage in the unprecedented scheme of so-called *indirect* small producer rate regulation at the pipeline level.

### B. The Decision Below

The court of appeals, with one judge dissenting, set aside the Commission's action exempting small producers from rate regulation after concluding that such action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).

The court's decision turned upon an analysis of specific provisions of the Natural Gas Act, namely, Sections 4, 5, 7 and 16 (FPC Pet., pp. 85a-93a). The court concluded, in effect, that the regulation of rates for jurisdictional sales was *mandatory,* and not discretionary or permissive, regardless of the size of the regulated entity. In that connection, the Commission's

Section 16 classification powers do not permit the exemption of small producers from rate regulation under Section 4 of the Act (FPC Pet., pp. 7a-10a). That being the case, the court held that the Commission's Order Nos. 428 and 428-B represented a clear-cut abdication of statutory duty to assure that *all* regulated rates, including those of small producers, be "just and reasonable" (FPC Pet., pp. 10a-16a). This departure from statutory duty and standards through the so-called "indirect" mode of regulation at the pipeline level contravened the provisions of the Natural Gas Act:

> "Nothing at all insures that those levels [of rates allowed to be passed on to consumers] will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a-13a).

## REASONS FOR DENYING WRITS

As shown below, the reasons for denying writs are twofold: (1) the decision below is clearly correct, and (2) there is no conflict of decisions to be resolved.

## I

## THE DECISION BELOW IS CLEARLY CORRECT

Although the court below was sympathetic to—in fact, applauded—the Commission's attempts to deal with the critical shortage of natural gas, the court, with

one judge dissenting, nevertheless set aside the Commission's action exempting small producers from rate regulation by shifting the responsibility to the pipeline purchasers. The court concluded that such action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).

### A. The Provisions of the Act.

The Commission's purported authority for exempting small producers from rate regulation by shifting the burden to the pipeline purchasers stems from Sections 4, 5, 7 and 16 of the Natural Gas Act. The clear and unambiguous language of the Act, however, leaves no doubt that the provisions of Sections 4 and 5 are *mandatory*. They are not permissive or discretionary as the Commission suggests.[7]

Section 4(a) provides:

> "*All* rates and charges made, demanded, or received by any natural gas company . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful." (Emphasis supplied.)

Section 4(b) provides:

> "*No* natural gas company shall with respect to *any* transportation or *sale* of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person . . . or (2) maintain any unreasonable differ-

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[7] The Commission in issuing Order No. 428 said: "We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no room for administrative judgment and discretion." (FPC Pet., pp. 30a-31a).

ence in rates, charges . . . between classes of service." (Emphasis supplied.)

Section 4(c) provides that:

> ". . . *every* natural-gas company *shall file* with the Commission . . . *schedules showing all rates* and charges *for any* transportation or *sale* subject to the jurisdiction of the Commission . . .". (Emphasis supplied.)

Section 5 is likewise clear. It provides that:

> "(a) Whenever the Commission, after hearing . . . shall find that *any* rate . . . charged, or collected by *any* natural-gas company . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission *shall* determine the just and reasonable rate . . . to be thereafter observed and in force and shall fix the same by order . . .". (Emphasis supplied.)

It is not surprising, therefore, that the court below found, after reviewing the above provisions, that they are *mandatory* and are applicable to *all* wholesale sales of natural gas in interstate commerce by producers irrespective of their size (FPC Pet., pp. 7a, 8a). A review of Sections 4 and 5, considered apart from Section 16, can lead to no other conclusion. Indeed, the Commission does not contend otherwise. To the contrary, the Commission asserts that its authority to exempt small producers from rate regulation by shifting its responsibility to the pipeline purchasers stems from its classification powers under Section 16 of the Natural Gas Act.

As the court of appeals held, the regulatory mandate of Sections 4 and 5 of the Act is in no way circumscribed or diminished by Section 16 classification powers which are designed for administrative con-

venience, and *not* as a device for expanding, contracting or otherwise changing the coverage of the Act:

> "Thus the Commission's power, under Section 16 of the Natural Gas Act, to 'classify persons and matters within its jurisdiction' and to 'prescribe different requirements for different classes' cannot validate this exemption of small producers. The Commission can only classify '[f]or the purposes of its rules and regulations.' It can only prescribe rules and regulations 'to carry out the provisions of this chapter.' Section 16 thus does not give the Commission independent powers. Rather, it provides for implementation of the core sections of the Act, such as Section 4." (FPC Pet., pp. 9a, 10a).

The court of appeals correctly concluded that only Congress could effectuate the change in the regulatory scheme sought by the Commission:

> "Only Congress can knowingly prescribe nonregulation for small producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* [*Phillips Petroleum Co.* v. *Wisconsin,* 347, U.S. 672 (1954)] to be mandatory under the Natural Gas Act for all producers." (FPC Pet., p. 16a; see also p. 17a, fn. 25).[8]

In relying on Section 16 for authority to shift the rate regulatory responsibility from small producers to the pipeline purchasers, the Commission cites its need for flexibility "to make pragmatic adjustments which

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[8] For pending legislative proposals affecting producer regulation under the Natural Gas Act, see S. 371, S. 1162, S. 1549, H.R. 480, H.R. 2533, H.R. 2866, H.R. 3299, H.R. 3566, H.R. 3685, and H.R. 7507, all 93rd Congress, 1st Session.

may be called for by particular circumstances."[9] The court below has correctly noted, however, that such latitude of regulatory agencies is restricted by "the ambit of their statutory authority." In short, there is no authority within the four corners of the pertinent provisions of the Natural Gas Act which justifies or validates the shift of rate regulatory responsibility as proposed by the Commission.

### B. Past Commission Actions Confirm the Lack of Statutory Authority.

It is of significance to note that, in the early days of producer regulation, the Commission's interpretation of its powers under the Natural Gas Act comports with the decision of the court below.

Shortly after the *Phillips* decision, and before the institution of area rate proceedings, the Commission acted to simplify the filings by small producers, relying upon its authority to prescribe different procedures for different classes of regulated companies under Section 16 of the Act, 15 U.S.C. 717o (FPC Pet., pp. 92a, 93a). Nevertheless, in so doing, the Commission recognized that the coverage of the Act was *mandatory*, and it stated in Order No. 174-B, 13 FPC 1576, 1577 (1954):

> "5. Some of the petitions urged that the regulations be amended to relieve small producers from

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[9] *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); see also, *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 642 (1972):

> "FPC and other agencies created to protect the public interest must be free, '*within the ambit of their statutory authority*, to make the pragmatic adjustments which may be called for by particular circumstances' [citing *Natural Gas Pipeline*]." (Emphasis supplied.)

the requirements of the statute. ***The Act does not provide for exemptions from its requirements,*** but the regulations for producers are herein revised in Sections 154.91, 154.92, 154.94 and 157.23 to further simplify the filings by small producers." (Emphasis supplied.)

Judicial recognition to the same effect is *Saturn Oil and Gas Company* v. *FPC,* 250 F.2d 61 (10th Cir. 1957), *cert. denied* 355 U.S. 956 (1958), wherein the Tenth Circuit stated:

> "***There is nothing in the Natural Gas Act which makes its applicability depend on the size*** or the integration ***of the gas operator***. The Phillips decision holds that the Act applies to *all* wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations." (Emphasis supplied.) 250 F.2d at 66-67.

Thus, the past history of producer regulation fully confirms and underscores the correctness of the decision of the court below that Section 16 does not provide authority for the Commission's actions herein.

### C. The Permian and Hunt Cases Do Not Support the Commission.

The Commission has attempted to construe this Court's decisions in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) and *FPC* v. *Hunt,* 376 U.S. 515 (1964) as supportive of its attempt to shift rate responsibility from small producers to pipelines. The Commission's reliance on these decisions is misplaced.

In its first area rate proceeding, the Commission provided for special treatment for small producers by exempting them from certain filing requirements under Sections 4 and 7 of the Act. 34 F.P.C. 159, 234, 235

(1965). On review, this Court held in *Permian* that the Commission's separate classification of small producers pursuant to Section 16 powers was consistent with its statutory responsibilities. 390 U.S. at 787. However, as the court of appeals noted, the small producers in *Permian* were expressly limited to the "just and reasonable" area rate determined by the Commission under Sections 4 and 5 of the Act. The court below said:

> ". . . the Commission is saying that the whole issue in the lawsuit is no different from *Permian*. That just isn't so. The absence of such a 'just and reasonable' limit *is* the big difference. Order No. 428 not only allows small producers to exceed the reasonable and just area rate ceilings—it allows them to do so on the basis of the free market, which is the antithesis of regulation." (Emphasis in original.) (FPC Pet., p. 11a, fn. 18).

Likewise, the Commission's reliance on *dicta* in *Hunt* suggesting that the Commission study NLRB exemption procedures was shown by the court of appeals to be inapposite; simply put, the Natural Gas Act, unlike the National Labor Relations Act,[10] does not give the FPC discretion to decline to exercise its jurisdiction over the seller of natural gas by purporting to regulate producer rates at the pipeline-purchaser level.

### D. The Commission's Theory of "Indirect" Regulation Is Invalid.

The Commission attempts to justify its action as "indirect" regulation of small producer rates. However, the Commission's assertion that it has not ex-

[10] 29 U.S.C. 160(a).

empted small producers' sales from ***substantive*** requirements of the Act (FPC Pet., p. 11) is totally at odds with reality; no amount of strained semantics can conceal the fact that small producers have, indeed, been relieved of the statutory "just and reasonable" standard with respect to their rates.[11]

With respect to the concept of "indirect" regulation, the court below took the Commission to task, pointing out that regulation and nonregulation are essentially different concepts, and that:

> "It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards. Since the Commission itself has not been confident enough to conclude that the market will necessarily yield rates that comply with the statute, this court can hardly uphold the Orders on that ground." (FPC Pet., p. 14a).

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[11] The Commission's attempt to shift the burden of small producer rate regulation to an "indirect" review of pipelines' justification of the contractually-negotiated prices paid to small producers represents a remarkable departure from prior practice. Before the effective date of the Commission's Orders exempting small producers from rate regulation, the affected producers either had rates on file with the Commission or were subject to area rate ceilings prescribed by the Commission. These rates were the only rates which the purchasing pipelines could legally pay for the purchased gas; having paid the filed or fixed rates, these purchased gas expenses could not be questioned in subsequent pipeline proceedings as to the propriety thereof. See generally, *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), and *Jupiter Corporation* v. *FPC*, 424 F.2d 783, 788 (D.C. Cir. 1969).

On this point, the Commission seeks solace in a footnote reference by the Fifth Circuit in its recent *Placid Oil Co.* v. *FPC* decision (No. 71-2761, decided April 16, 1973) to the effect that regulated rates *may* get closer and closer to a basis of existing market conditions. Of course, the Fifth Circuit was speaking of a regulated rate determined by the Commission as "just and reasonable," an essential distinction not present here. If the rates of small producers were based upon existing market conditions and were validly determined by the Commission to be "just and reasonable," the pipelines would have no complaint since, under such circumstances, they (the pipelines) would be assured that the *full* cost could be included in their rates. In sharp contrast, the Commission issued Order No. 428 without such a finding by granting blanket authorization to all small producers to charge whatever they were able to negotiate with the pipeline purchasers.

The Commission also seeks to support its action as experimental in nature. The court below, while sympathetic to the Commission's problems in coping with the shortage of natural gas and having, itself, approved "experiments" on that basis in the past,[12] could not condone the Commission's proposed "indirect" regulation, which it characterized as an experiment in "*non*regulation" (FPC Pet., p. 17a).

The Commission's belated reliance on Section 5 powers is, we submit, self-defeating. This *post hoc* rationalization, which we see for the first time in the Commission's petition for certiorari (FPC Pet., p.

[12] FPC Pet., p. 7a, fn. 7.

12), is wholly at odds with the previously stated iron-clad assurance that small producers' contract prices would *not* be subject to reduction and refund (see page 4, *supra*). To *now* add the possibility of a reduction in the rates of small producers under the powers of Section 5(a) of the Act will only compound the regulatory uncertainty and risk and will be, obviously, counter-productive to the Commission's entire rationale underlying the proposal involved in the instant rulemaking.

Finally, this Court has previously rejected the Commission's theory of "indirect regulation" of producers under the Natural Gas Act. As far back as 1951, the Commission rendered a decision in which it ruled that Phillips Petroleum Company was not a "natural-gas company" within the meaning of the Natural Gas Act (10 F.P.C. 246 (1951)). In partial justification of its interpretation of the Act, the Commission stated:

> "Likewise, in the exercise of its power to regulate the wholesale rates charged by interstate pipeline companies, this Commission has ample authority to inquire into the reasonableness of all items of operating expense—including the cost of purchased gas—and to disallow, for purposes of rate-making, items of cost which are collusive or otherwise improperly excessive." (*Id.* at 280).[13]

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[13] *Contra, Texas Eastern Transmission Corporation, et al.*, 29 F.P.C. 249 (1963), *aff'd sub nom. United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965), where the Commission stated the better view (at p. 256): "Control limited to approving the costs of gas to the purchasing pipeline is, of course, not an effective way to regulate producer prices because in the large *a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities.*" (Emphasis supplied.)

Subsequently this Court, in its landmark decision in *Phillips, supra,* flatly rejected the Commission's interpretation of the Act and held:

> ". . . we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." (Emphasis supplied and footnote omitted.) 347 U.S. at 682.

## II

## THERE IS NO CONFLICT OF DECISIONS

The Commission argues (FPC Pet., pp. 12, 13) that the decision below is contrary to this Court's decision in *Permian, supra,* which held open the possibility that the "records in subsequent area rate cases might more clearly establish that the market mechanism will adequately protect consumer interests." 390 U.S. at 795. Such an argument is premised on an overstatement of the court of appeals' discussion of this question. The decision below does not foreclose the possibility that the "records in subsequent area rate cases" might justify reliance upon market forces in the regulation of producer prices and, accordingly, does not conflict with *Permian* (FPC Pet., p. 12a, fn. 20). In this connection, the court refers, with seeming approval, to the Commission's recently issued rulemaking Order Nos. 455 and 455-A (FPC Pet., p. 13a, fn. 21) which establish an "optional certification procedure" for new gas sales.[14] And, like the matter here-

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[14] Order Nos. 455 and 455-A are pending judicial review in the D. C. Circuit, *Moss* v. *FPC* [No. 72-1837] and *APGA* v. *FPC* [No. 72-1846].

in, these orders seek to assure producers—without regard to their size—of receipt of their certified contract prices throughout the contract term. Thus, as to new gas, Order Nos. 455 and 455-A would do for *all* producers, large and small, what the Commission was attempting to do for only small producers in Order Nos. 428 and 428-B, i.e., give the certainty of contract rates. The one significant distinction, however, is the requirement, under the optional certificate procedure, that the contract be first submitted to the Commission in order that the pricing provisions may receive approval as "just and reasonable."

## CONCLUSION

The petitions for writ of certiorari should be denied.

Respectfully submitted,

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FEDERAL POWER COMMISSION

v.

TEXACO, INC., ET AL.

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No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL.

v.

TEXACO, INC., ET AL.

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**On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## BRIEF FOR THE PUBLIC SERVICE COMMISSION FOR THE STATE OF NEW YORK IN OPPOSITION

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### PRELIMINARY STATEMENT

The Public Service Commission for the State of New York (New York), the petitioner in one of the cases consolidated for briefing and argument below, files herewith its opposition to the petitions for certiorari in Numbers 72-1490 and 72-1491. The petitions seek plenary review of the Opinion and Order of the Court of Appeals for the District of Columbia Circuit (Pet. App.

1a-22a; 23a-25a)[1] setting aside certain orders of the Federal Power Commission prescribing a new method of "regulating" the price of sales by small producers of natural gas in interstate commerce for resale. New York is the regulatory body established by the State of New York to control, *inter alia*, the rates at which natural gas is distributed at retail in the state. As such it is directly interested in proceedings before the Federal Power Commission to fix the rates at which natural gas may be sold to the pipelines serving New York, and participated actively both in the proceedings before the Commission and in the court below.

## QUESTION PRESENTED

Whether the Court of Appeals correctly determined that the Federal Power Commission has no authority to exempt small producers from all direct regulation of the rates in which they sell gas in interstate commerce for resale, and to limit the indirect regulation of such sales in the rate proceedings of pipeline and large producer purchasers to the possible disapproval of purchased gas costs resulting from contract prices in excess of both the *highest* rate at which any large producer contracted to sell gas in interstate commerce in the area or the prevailing contract rates of *unregulated* intrastate sales therein?

## STATEMENT OF THE CASE

### I. Background

Ever since *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, questions have been raised as to the appropriate procedures for regulating the numerous small producers of natural gas who account for a relatively small

[1] "Pet. App." refers to the appendices to the Petition in Case No. 72-1490.

portion of the total volumes of gas, and purchased gas costs of the interstate pipelines. Since there are more than three thousand separate entitles engaged in natural gas production and sale for resale in interstate commerce, questions were presented as to how the Commission could manage its responsibilities, and equally important, how the administrative expenses of regulation could avoid imposing an unnecessary economic burden on the smaller producers. The problem was peculiarly acute during the eight-year period subsequent to *Phillips* when the Commission operated on the assumption that the proper manner of regulating producers was the individual company basis it had applied in the case of pipelines and electric utilities. The avoidance of the administrative morass consequent upon the holding of thousands of separate proceedings was one of the principal factors that led the Commission in the second *Phillips* case, 24 FPC 537 (1960), to move to area rates as the solution for its producer rate problems.

The Commission's determination to abandon individual producer rate cases was affirmed in *Wisconsin* v. *Federal Power Commission*, 373 U.S. 294. In his dissenting opinion there (373 U.S. at 329-330), Mr. Justice Clark first raised the question of a possible "temporary" exemption of small producers while the Commission concentrated on the rates of the largest individual producers. This, he suggested, might be a more effective approach to the administrative problem than the area rate technique. Subsequently, in *Federal Power Commission* v. *Hunt*, 376 U.S. 515, 527 (1964), Justice Clark, here speaking for a majority of the Court in a certificate case, suggested that the administrative delay resulting from dealing with all producer sales certificate applications on an individual basis, might be avoided if the Commission found itself in a position to utilize exemption practices similar to those then followed by the National Labor Relations Board.

In the *Permian Basin Area Rate Proceeding*, 34 FPC 159 (1965), the first of the area proceedings, the Commission came to grips with the problem of the small producers. The Commission concluded (34 FPC at 234-235) that special treatment for small producers which would ease the burdens of regulation without the risk of substantial impact on consumer prices would be in the public interest. But it also determined (*ibid.*) that an outright exemption of small producers, assuming it was legally permissible, was neither "necessary nor desirable." In reaching this determination, the Commission found that "the impact of small producer prices on consumers is by no means *de minimus* and is of great impact in some instances" (34 FPC at 235). The Commission also found that the penetration of the rate ceilings which would result from an absolute exemption of small producer sales from rate regulations could be "seriously disruptive of a pattern of uniform area rates" (*ibid.*).

While making the area just and reasonable rates applicable to all producers, small and large alike, the Commission in *Permian* initiated action, consummated by Order 308 issued on November 5, 1965, (*Rate and Certificate Filings by Small Independent Producers*, 34 FPC 1202), to relieve small producers of virtually all of the administrative burdens and costs of both the rate and certificate provisions of the Natural Gas Act. This action took the form of the establishment of "Small Producer Certificates" available to any producer with jurisdictional sales of less than 10,000,000 Mcf of gas per year, under which the producer would be able to make all of its existing sales, and any new ones, without seeking further authorization from the Commission as long as his total annual sales did not exceed the prescribed maximum, and the price therefor did not exceed the applicable just and reasonable ceilings for such gas in the particular area.

In addition, the Commission in its *Permian* decision gave small producers the option of being relieved from the rate adjustments it imposed on large producers with respect to abnormal gas quality conditions (see 34 FPC at 225). This exception to the general area rate structure was justified by the Commission on grounds of its *de minimus* effect on the overall gas costs and the fact that the costs of determining the necessary quality adjustments for the many small producers would be greater than the total amount of the adjustment.

In its decision affirming the Commission's Permian Basin opinions, this Court expressly affirmed the Commission's treatment of small producers. Specifically, it found that the Commission had a proper factual basis in the record for classifying small producers separately, and that the "carefully selected special arrangements for small producers" which the Commission had found "would not improperly increase consumer prices" were "fully consistent with the terms and purposes of [the Commission's] statutory responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 787 (1968). The Court's opinion, of course, does not hold that the Commission's power to classify small producers for special regulatory treatment authorized it to exempt them from all effective rate regulation; the Commission had rejected this approach and it was not advocated by any party in the Supreme Court review of the Commission's decision.

## II. The Present Proceeding

The instant case was instituted by a Notice of Proposed Rule Making (R. 1) issued by the Commission in Docket No. R-393 on July 23, 1970. In this Notice the Commission proposed simply to exempt most small producers from all provisions of the Natural Gas Act and the Commission's regulations thereunder, except for the requirement of the existing small producer rule that they file an annual statement setting forth the total volume of their jurisdictional sales (R. 2-3).

In justification for its proposed action the Commission suggested that the relief previously granted under the existing Small Producers Certificate program "has been inadequate for small producers since they still bear many of the expenses and burdens of complying with regulatory requirements, particularly when they seek the same treatment accorded large producers. Such relief has also increased the difficulties inherent in processing small producer filings from an administrative viewpoint instead of decreasing these problems as was intended." (R. 2) In addition, the Commission stated that exempting small producers from compliance with the Natural Gas Act should encourage them to increase their exploratory efforts. The Commission suggested that the impact of the proposed exemption on consumers should be "minimal" since small producers account for a relatively small share of the gas produced nationally and are not normally in a position to obtain more for their gas than the large producers whose sales are subject to the just and reasonable area rate ceilings (R. 2).

No attempt was made in the Notice at a legal justification for the Commission's action, other than a general reference to Justice Clark's suggestion in the *Hunt* case, *supra*, that the Commission consider the availability of exemption procedures (see R. 2-3).

Following the receipt of comments, many of which opposed the exemption proposal or recommended substantial modification thereof, and the holding of an informal conference between the members of the Commission staff and all interested parties, in which many of the objections expressed in the written comments were further detailed, the Commission on March 18, 1971, issued its Order 428 in the proceeding (Pet. App. 29a). While this order was denominated as an "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief From Detailed Filing Requirements" it did

nothing significant in either respect which had not been accomplished in the Small Producer Certificate procedure established by Order 308 over five years earlier. Instead, the new Order, while no longer purporting to exempt small producers from all rate regulation under the Natural Gas Act, in effect achieved this objective. It did so by relieving the small producer of all necessity for complying with the just and reasonable area rate ceilings which had been adopted for the various production areas or any other maximum price limitations.

This action, the Commission stated, did "not constitute deregulation of sales by small producers" (Pet. App. 32a), since it would "continue to regulate such sales at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales." But the "consumer protection" to be afforded by such review was promptly vitiated by the assurances the Commission gave to the pipeline, and the large producer purchasers of gas from small producers, that they would be permitted to pass on to their customers *all* higher prices they might pay small producers for gas as long as the rate was not "unreasonably high considering appropriate comparisons with *highest contract* prices for sales by large producers or the prevailing market price for *intrastate* sales in the same production area" (Pet. App. 35a, 37a, emphasis added).

The Commission's justification for its action is sparse, and limited to summary statements of objective. It confines its legal analysis of its action to a bare denial of the claim that the provisions of Section 4, 5 and 7 of the Act are "mandatory and leave no room for administrative judgment and discretion," and a reference to the Supreme Court's language in the *Permian Basin Area Rate Cases*, noted above, relating to the Commission's classification powers under Section 16 (Pet. App. 31a). On the merits, the Commission no longer concludes that

the impact of its action, which it found will affect over 10% of the gas purchased by pipelines from producers and an unspecified additional amount of gas purchased by large producers for resale to pipelines (Pet. App. 37a), is *de minimus*. But it repeats the statements from its Notice that its action will ease the administrative burdens on the small producers and in its processing of small producer filings (*ibid.*). And it concludes, in general terms, that its actions, though not intended to increase contract prices, should encourage small producers exploratory efforts and facilitate the entry of the small producer to the interstate market (*ibid.*). Nothing whatsoever is stated in the Commission's Order as to why the removal of all price ceilings from flowing gas already committed to the interstate market by the small producer will result in any public benefit.

New York filed, on April 19, 1971, a petition for rehearing of Order No. 428 (R. 410). Numerous other parties also filed petitions for rehearing. In Order 428-B, issued July 15, 1971, the Commission, with minor exceptions not here relevant, denied the applications for rehearing (Pet. App. 50a).

The Court of Appeals for the District of Columbia Circuit (Judges Wilkey and Robinson, with Judge Fahy dissenting) reversed (Pet. App. 1a-22a). It did not dispute the Commission's right to classify small producers separately for rate making purposes, or to provide different or higher rates for such producers upon a record providing a factual predicate therefor. But it concluded that the Commission's rule, in freeing small producers from all direct price restrictions and tying the indirect regulation through control over the purchaser to sales at prices above the *highest contract price* for a contemporaneous sale by a large producer in the area or the prevailing market price for the unregulated intrastate sales, had failed to meet the just and reasonable standards established by

Section 4 of the Act for all sales in interstate commerce for resale. In so holding, the Court expressly rejected the contention that "while the Commission would no longer be regulating rates, the *market mechanism* itself would, in effect, dictate small producer prices which were 'just and reasonable.'" (Pet. App. 13a, emphasis in original). The Court held that this *post hac* rationalization not only ignored the essential difference between a regulated and unregulated industry, but was inconsistent with the Commission's orders which contained no conclusions that the market will necessarily yield rates which comply with Act's just and reasonable standard (Pet. App. 14a).

## ARGUMENT

The Court below expressly affirmed the right of the Commission to classify small producers separately for substantive as well as procedural rate making purposes (Pet. App. 7a). It concluded, however, that the particular Commission action under review here, which completely removes small producers from any direct rate regulation under the Natural Gas Act and limits indirect regulation through the purchasers to circumstances in which the per Mcf sales price of the gas exceeded market norms, was impermissible under the standards of the Act.[2] Its decision is clearly correct and raises no question calling for this Court's plenary review.

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[2] The "Question Presented" in No. 72-1490 (FPC Pet. 2) suggests, *inter alia*, that questions are presented as to the authority of the Federal Power Commission "to exempt small producers from certain filing requirements under the Natural Gas Act." See also FPC Pet. 10. But nothing in the lower court's opinion in any way deprives the Commission of the right to exempt the small producer from any filing requirements of the Act, as distinguished from the substantive requirements of Sections 4 and 5 that all producers rates be just and reasonable. Specifically, nothing in the lower court's opinion in any way suggests that the blanket "small producer certificates" established by Commission Order No. 308 in 1965 (see *supra*, p. 4), was not a proper exercise of the Commission's authority.

1. The Commission's orders remove all regulatory limits on the rate a small producer may charge for sales made in interstate commerce for resale, with respect to both new sales and flowing gas. The entire regulatory control allegedly asserted is an indirect one imposed upon the purchaser in terms of the circumstances in which the latter will be permitted to pass on higher rates resulting from small producer sales to their customers. Even in a situation where the purchaser is not permitted to do so, the small producer is not affected, and may continue to collect the higher rate.

It is true that these rates will, as a matter of law, remain subject to *prospective* revision under Section 5(a) of the Act, despite the Commission's attempt to assure the small producers to the contrary (Pet. App. p. 31a). But this Court has long since made clear that the residual power of the Commission under Section 5 is not a permissible substitute for authorizing sales to be made at rates above the just and reasonable level. *Atlantic Refining Company* v. *Public Service Commission*, 360 U.S. 378. And the reference in the petition for certiorari (p. 12) to the Commission's statement that it would take "further action" to protect consumers if its program turned out to be inimical to their interests, is equally without significance since the only alternative action to a prospective Section 5(a) proceeding would be the *prospective* termination of the rules it here adopted.

We agree with the court below (Pet. App. 7a, 10a and n. 17) that there is considerable question whether such indirect regulation of sales through the exercise of control over the eventual purchaser is lawful under the standards of the Act, which in terms are applicable to "all rates and charges . . . by *any* natural gas company (Natural Gas Act, Section 4). But, we also agree with the Court of Appeals that it is unnecessary to resolve this question since, even if indirect regulation could be

justified in other circumstances, the standards established for such indirect regulation by the present rule are patently unlawful. For the Commission held that the price for gas in small producer sales will not be challenged as "unreasonably high" in considering the right of the purchasers to pass the costs to their customers, as long as they are consistent with the "*highest* contract prices for sales by large producers or the prevailing market price for *intrastate* sales in the same producing area" (Pet. App. 35a, 37a). As the Commission's petition for certiorari frankly admits (pp. 12-14), this merely equates the just and reasonable standards of the Act with the unregulated "market mechanism." The intrastate market is not regulated at all, and large producer contract prices, to say nothing of the highest such price, have traditionally been established at rates substantially higher than the Commission has prescribed as the just and reasonable ceilings in the hopes of subsequent deregulation or regulatory changes.

The Commission's attempt to portray the lower court's decision as being in conflict with this Court's decision in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 795 is spurious. The Court in *Permian* did not hold that the Commission could lawfully equate market prices with the just and reasonable rates mandated by the Natural Gas Act, but merely stated it was not there pretermitting such a conclusion in the event the Commission in subsequent area rate proceedings "clearly established"—contrary to the findings the Court expressly upheld in *Permian*—that the market mechanism will adequately protect consumer interests. There has been and could be no such determination in the present proceeding. The Commission made no investigation of the ability of either the interstate or intrastate market structure to protect the consuming public, and its orders contain no findings or even summary conclusions to this effect. On the con-

trary, in the various area rate decisions issued subsequent to its order here, where there was record evidence and arguments directed to the issue, the Commission has continually rejected the contention that it should or could set rates on the basis of "what-the-traffic-will-bear" *Southern Louisiana Area Rate Proceeding*, 46 FPC 86, 126 (1971), affirmed, *Placid Oil Company et al.* v. *Federal Power Commission*, C.A. 5, No. 71-2761, decided April 16, 1973. See also, *Texas Gulf Coast Area Rate Proceeding*, 45 FPC 674, petitions for review pending, *Public Service Commission et al.* v. *Federal Power Commission*, Case No. 71-1828, D.C. Cir.; *Other Southwest Area Rate Proceedings*, 46 FPC 900, petitions for review pending, *Shell Oil Company et al.* v. *Federal Power Commission*, Case No. 72-1114, 5th Cir.

The simple fact is that the Commission carefully refrained in any of its orders under review from finding that the rates the small producers could charge thereunder, or even those it provided the purchasers could pass on to their customers, were "just and reasonable". Instead, as the lower Court noted (Pet. App. 14a), the Commission's brief below expressly conceded that "[t]he Commission's order does not purport to determine the just and reasonable rates for sales by small producers." As far as rate regulation is concerned, the Commission merely concluded that the public interest in a time of gas shortage would best be served by removing all restrictions on this limited, but by no means *de minimus* part of the market.[3] This may arguably be a viable legislative position and the Administration is presently

[3] While the Commission's original notice of rulemaking suggested the impact of its proposed rule would be *de minimus*, it admitted in Order 428 that it would affect 10.52% of all pipelines purchases, and that the impact on some pipelines would be twice as great (Pet. App. 32a). Moreover, the Commission made clear (*id.* at n. 1) that these figures did not include small producer sales to large producers for resale to the pipelines.

sponsoring legislation which would free all *new* producer sales from the Commission's regulatory authority.[4] But, at least on this record, it cannot conceivably be upheld as an appropriate application of the existing standards of the Natural Gas Act.

2. The Commission's petition for certiorari does not seriously contend that the opinion below would preclude it from taking such appropriate and lawful action, either with respect to small producers or producers as a whole, as might be required to increase gas supplies while at the same time protecting gas consumer producers from exploitation as a result of the existing supply-demand imbalance. Specifically, the Court's decision does not preclude the Commission from establishing separate and higher just and reasonable rate ceilings for small producers upon the basis of findings, resting on an adequate factual predicate (see *City of Chicago* v. *Federal Power Commission*, 458 F.2d 731 (D.C. Cir., 1971), *cert. den.*,

[4] See President's Message on Energy, 119 Cong. Rec. (Daily Ed., April 18, 1973) pp. S 7692-98; letter of April 18, 1973 to the Speaker of the House from the Acting Secretary of the Interior submitting proposed bill "to amend the Natural Gas Act to the extent its application to the direct sales of natural gas in interstate commerce, and to provide that provisions of the Act shall not apply to certain sales in interstate commerce." 119 Cong. Rec. (Daily Ed., April 18, 1973) p. H 2976. The draft bill, subsequently introduced as H.R. 7507, provides that the provisions of the Act shall not apply to the sales of natural gas by an independent producer "dedicated for the first time to interstate commerce or rededicated upon the expiration of an existing contract on or after April 15, 1973, or produced from wells commenced on or after April 15, 1973. . . ."

The President's Energy Message made clear (*id.* at S 7693), that to protect consumers against "precipitous cost increases", and to avoid "generating windfall profits", the Administration was not advocating the general deregulation of the prices paid for flowing gas. However, as indicated, *supra*, Commission Order 428 would apply to all flowing gas production of small producers as well as to new sales thereby.

405 U.S. 1074 (1972), that their average costs[5] or some other factors so require. Nor does the Court's opinion in any respect freeze the Commission's rate determinations either with respect to small producers as a class or producers in general, into the regulatory framework the Commission adopted with this Court's approval in the *Permian Basin Area Rate Cases, supra.*

On the contrary, the Commission in the period since the issuance of its orders here, adopted or initiated a number of programs intended to increase the rates or revenues of gas producers, including small producers. See, *e.g.*, *Accounting and Rate Treatment of Advance Payments*, Order No. 465, issued December 29, 1972, 38 F.R. 1385;[6] *Optional Procedure for Certificating Sales of Natural Gas in Interstate Commerce*, Order No. 455,

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[5] To the best of our knowledge, the only proceeding in which there was an effort made to determine whether small producer costs, on the average, were greater than those for producers generally was the *Permian Basin* proceeding, *supra*. The record data was, however, inconclusive and the Commission made no finding on the point, aside from concluding that an outright exemption of small producers, assuming it was legally permissible, was not "necessary or desirable" (34 FPC 159, at 234-235). The only findings the examiner could make in the light of the conflicting and incomplete data was that "on a per Mcf basis, the small producers had relatively larger dry hole expenses, a smaller proportion of geological and geophysical expenses, and a smaller proportion of lease acquisition expenditures. On a unit basis, smaller producers had a relatively larger DD&A expense than the larger producers" (34 FPC at 361).

[6] New York has filed a petition for review of this Order (*Public Service Commission* v. *Federal Power Commission*, No. 73-1338 (D.C. Cir.)) because of its belief that, particularly with respect to its application in off-shore areas in the Federal domain subject to the Commission's plenary jurisdiction, the Commission's order goes far beyond what has been justified by the record on which it relied. But the Commission's legal authority to adopt such a program to the extent it has a factual predicate for its action has been previously affirmed. See *Public Service Commission* v. *Federal Power Commission*, 467 F.2d 361 (D.C. Cir.).

issued August 3, 1972, appeals pending *Moss et al* v. *Federal Power Commission* (D.C. Cir., No. 72-1837); *Policy With Respect to Sales Where Reduced Pressures, Need for Reconditioning, Deeper Drilling or Other Factors Make Further Production Uneconomical at Existing Rates*, Order No. 481, issued April 12, 1973, 38 F.R. 9994; see also, *Just and Reasonable National Rates for Future Sales of Natural Gas from Wells Commenced on or After January 1, 1973*, Docket No. R-389-B, Notice of Proposed Rulemaking of April 11, 1973, 38 F.R. 10014. In short, while the possibility would in any event not justify action contrary to the standards of the Natural Gas Act, there is no basis for concluding that setting aside Order 428, as directed by the Court of Appeals, would significantly affect the Commission's power to take appropriate action with respect to the rates which can lawfully be charged by small producers.

## CONCLUSION

The Court of Appeals' decision herein is clearly correct and the petitions for a writ of certiorari raise no questions regarding plenary review by this Court. It should, accordingly, be denied.

Respectfully submitted,

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June 4, 1973

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## MISCELLANEOUS

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972

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No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner*

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No. 72-1491

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v.

TEXACO INC., ET AL.

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**On Petitions for Writ of Certiorari to the United States Court Of Appeals for the District of Columbia Circuit**

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## BRIEF IN OPPOSITION OF TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO INC.

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### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. pp. 1a-22a)[1] is reported at 474 F.2d 416. The initial order (No. 428) of the Federal Power Commission (Pet.

[1] "Pet. App." refers to the appendices to the petition in No. 72-1490.

App. pp. 29a-46a), its order (No. 428-A) of amendment (Pet. App. pp. 47a-49a), and its order (No. 428-B) denying rehearing (Pet. App. pp. 50a-84a) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

## JURISDICTION

The judgment of the court of appeals was entered on December 12, 1972 (Pet. App. pp. 23a-25a). Petitioners' petitions for rehearing were denied on February 5, 1973 (Pet. App. pp. 26a-28a). The petitions for a writ of certiorari were filed on May 3, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTION PRESENTED

Whether the Natural Gas Act vests discretion in the Federal Power Commission to exempt small producers from the just and reasonable rate requirements provided in Section 4 and 5 of the Act and to attempt to close the resulting regulatory gap indirectly through review of the prices charged by such small producers as costs to the purchasers in proceedings involving the rates of such purchasers.

## STATUTE INVOLVED

The pertinent provisions of Section 1(b), 4, 5 and 16 of the Natural Gas Act, 15 U.S.C. 717(b), 717c, 717d and 717o are set forth in the Appendix, *infra* pp. 1a-2a.

## STATEMENT OF FACTS

By Notice of Proposed Rulemaking issued July 23, 1970, the Federal Power Commission proposed "prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional

sales made by small producers", *i.e.* producers whose total jurisdictional sales do not exceed ten million Mcf of natural gas annually. 35 Fed. Reg. 12220. Following the submission of written comments by various affected producers, pipelines,[2] distributors and State Commissions, and the holding of an informal conference, the Commission promulgated its Order No. 428 here involved (Pet. App. 29a-46a).

By this Order which is captioned "Exemption of Small Producers from Regulation", the Commission provided for the issuance of blanket certificates to small producers under which they would thereafter be exempt generally from the rate, certificate and other filing requirements provided in the Natural Gas Act and the Commission's regulations thereunder (Pet. App. 42a-43a).[3] Under such certificates small producers would *inter alia* be "authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract" (Pet. App. 43a). In addition, they would be relieved of the obligation to make refunds with regard to any excessive rates (Pet. App. 37a).[4]

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[2] Respondent, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee) filed comments as an affected pipeline company.

[3] Except for the filing of an abbreviated annual report setting forth their total annual volume of jurisdictional sales (Pet. App. 45a), and for compliance with the abandonment provisions of Section 7(b) of the Act (Pet. App. 38a-39a, 43a-44a).

[4] In addition to small producer rates no longer being limited by the area rates generally applicable to jurisdictional sales of gas, the Commission ruled that although it had previously held certain types of escalation clauses to be inoperative as contrary to the public interest, it would permit such clauses to operate to increase small producer rates *up to* the applicable area or guideline rates (Pet. App. 32a).

In its Order, the Commission observed that the Natural Gas Act did not require it to regulate all jurisdictional sales of natural gas and left room for the exercise of administrative judgment and discretion such as were involved in its proposed small producer exemption (Pet. App. 30a-31a). Further, it asserted that exempting small producers from the Act's requirements constituted an important step in its discharge of its responsibilities of assuring an adequate gas supply for the interstate market (Pet. App. 31-32a):

> "Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the administrative burdens connected with processing small producer filings."

The proposed exemption for the small producers, the Commission went on "does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of such pipeline with regard to small producer sales" (Pet. App. 32a). Adoption of such indirect regulation, the Commission claimed, came within its "ample authority to inquire * * * into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent." (Pet. App. 33a).

Thus, as a substitute for its direct regulation of the rates for small producer sales to pipelines and large

producers, the Commission proposed that resales of such gas by the pipelines and large producers

> "* * * be subject to reduction and refund, with respect * * * to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in (1) a pipeline rate case or (2) a proceeding involving only the track ing increase.[5] Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. * * * In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests." (Pet. App. 37a)[6]

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[5] Purchasers from small producers were permitted to file tracking increases

> "only if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or orders, affect the pipeline's average cost of purchased gas by one mill or more" (Pet. App. 38a).

The effect of this requirement for Tennessee is that it has to absorb all small producer increases until the accumulated total amount of such increases, either alone or together with other increases authorized for tracking, is approximately $1,200,000 in annual gas purchase costs.

[6] By Order No. 428-A the Commission prescribed the form of annual statement to be filed. See Pet. App. pp. 47a-49a. By Order No. 428-B, the Commission denied the applications for rehearing filed, *inter alia*, by Tennessee and reaffirmed its basic rulings in Order No. 428 after eliminating some of the retroactivity contained in that order (Pet. App. 50a-84a).

On appeal by several affected large producers and pipelines, including Tennessee, the court below held that Congress had made the statutory just and reasonable rate standards applicable to all wholesale sales of natural gas in interstate commerce, and had not vested any discretion in the Commission to exempt any such sales from direct Commission regulation (Pet. App. 7a-10a). Moreover, the court below pointed out that the so-called indirect control of small producer prices through regulation of large producers and pipelines was not a complete substitute since the purchased gas costs to be passed on by such purchasers were to be measured not by the statutory just and reasonable standard but by whether the price paid by these purchasers were

> "unreasonably high, considering appropriate comparisons with ***highest contract prices*** for sales by large producers ***or*** the prevailing market price for ***intrastate*** sales in the same producing areas" (Pet. App. 11a). (Emphasis in original)

In other words, the court noted (Pet. App. 12a-13a):

> " * * * At best, the indirect controls [the Commission] has proposed will insure that the small producer rates which are passed on to consumers are below levels set by private contracting parties (or potentially by state regulation which is not necessarily tied to the federal standard). Nothing at all insures that those levels will be 'just' or 'reasonable'. That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a

government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing."

Further accepting the validity of "the Commission's motives [and] its opinion that some form of deregulation of small producers might benefit the consumers of natural gas" (Pet. App. 5a), the court pointed to the recent cases in which it had approved various Commission experiments designed to alleviate the gas shortage (Pet. App. 7a).[7] However, it held that it could not approve the Commission action here since that action went beyond the limits on the Commission's authority (Pet. App. 7a). In this regard, the court further commented (Pet. App. 16a):

> "* * * we cannot hold that *non*regulation is the statutory equivalent of regulation. Only Congress can knowingly prescribe nonregulation for small producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* to be mandatory under the Natural Gas Act for all producers." (Emphasis in original).[8]

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[7] *Public Service Commission* v. *F.P.C.*, 467 F.2d 361 (D.C. Cir. 1972); *Public Service Commission* v. *F.P.C.*, — F.2d — (Nos. 71-1197, *et al.*, decided 16 May 1972).

[8] In so holding, the Court also noted (Pet. App. 16a):

> "All of this is not to say that a proper regulatory determination, within the letter and spirit of the Natural Gas Act, could not set a just and reasonable rate for small producers higher than that for large producers. Given the special problems and practices of small producers, such a result is certainly conceivable. But the small producers cannot be exempted from the regulatory scheme, and have their prices tied to the free market, by administrative agency fiat."

In his dissent, Judge Fahy agreed that "all rates and charges of any natural-gas company * * * which includes the small producers * * * shall be just and reasonable and if not, that they are unlawful." (Pet. App. 18a). However, he claimed that "no particular rate or charge [was] before [the court] for scrutiny as to its justness or reasonableness" (Pet. App. 18a). Further observing that the Commission had authority to classify small producers separately (Pet. App. 19a), he took the position that

> "the Commission had [not] abdicated its responsibility to insure that rates of small producers will be just and reasonable. It does not appear from the record before us that any such price that might be charged is reasonably unjust or unreasonable. * * * Moreover, consumer protection is promised and I cannot now hold that the promise will not be fulfilled" (Pet. App. 21a).

Accordingly, while he would have affirmed Order No. 428 generally on the theory that it would not "lead inevitably to unjust or unreasonable rates charged by small producers" (Pet. App. 19a), he nevertheless

> "* * * would strike its provisions prohibiting refunds to pipelines and large producers, leaving open to the Commission to exercise such authority as it has to protect large producers and pipelines in the event the Commission finds they have been charged unreasonably high prices by small producers. * * * Should such a modification temper to a degree the charges of small producers, I think that result must be accepted as required by the public interest represented by the Act. I do not think such possible tempering would go so far as to defeat the purposes of Order No. 428." (Pet App. 22a)

## ARGUMENT

There is no question that there is an acute shortage of natural gas and that the Commission should be permitted "to make pragmatic adjustments in its regulatory procedures" to help alleviate that shortage (see Pet. p. 9). However, the Natural Gas Act provides limits within which the Commission may act and hence, as the Commission explicitly recognizes (Pet. p. 9) any such adjustment can be valid only if it is "consistent with [the Commission's] regulatory obligations." The Court below has held that the Commission's proposal here to exempt small producers' prices from direct Commission regulation and instead to review such prices indirectly as reflected in costs to the purchasing pipelines and large producers, exceeded the limits upon the Commission's authority. Since, as shown below, this holding is clearly required by the plain language of the Natural Gas Act and its legislative history, review by this Court is unwarranted.[9]

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[9] It is far from clear whether in any case, the Commission action is suited to achieve its purported objective. In addition to the absence of any showing that small producers need incentives, over and above those being provided to producers generally, to increase their exploratory activities, there is no evidence or statistics in the record as to the number of small producers which could be expected to initiate such activities in response to the Order No. 428 incentive. Indeed, since the exemption applies only to the first 10,000,000 Mcf annual volume sold, and small producers of necessity are already making some sales (with the most successful probably at or approaching the 10,000,000 Mcf annual level), the purported incentive could at most have only very limited effect, *i.e.*, only so long as the small producer sales continue to remain below the 10,000,000 Mcf level.

1. Contrary to the Commission's *present* argument (Pet. pp. 12-13) [10] both the intent and end-result of Order No. 428 clearly are to free small producers from the substantive requirements of the Natural Gas Act, including specifically the just and reasonable rate standards prescribed in Sections 4 and 5 of the Act. Freedom from these restraints obviously constitute the added incentive being offered to small producers to explore for new gas reserves. Small producers in many areas had already been freed from compliance with most of the Act's other requirements including the need to obtain Commission permission before raising their prices up to the applicable just and reasonable area rate. Order No. 308, 34 FPC 1202 (1965); Section 157.40 of the Commission Rules and Regulations under the Natural Gas Act; cf. *Permian Basin Area Rate Cases,* 390 U.S. 747, 784-787 (1968).

Moreover, Order No. 428's provisions for permitting small producers to charge the prices specified in their contracts and relieving them of refund obligations with respect thereto (see Pet. App. 37a, 43a, *supra* p. 3), serve further to demonstrate the Commission's understanding that the prices to be charged by the small producers would exceed the applicable just and reasonable area rates. Indeed, if, as the Commission now claims, small producer rates were to remain

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[10] As pointed out by the Court below (Pet. App. 8a), the Commission in Order No. 428 undertook to justify its action on the ground that the Act did not impose a mandatory obligation upon it to regulate all wholesale sales of gas. See Pet. App. 30-31a, *supra* p. 4. Similarly, the Commission's brief before the Court below flatly conceded (at p. 35) that "[t]he Commission's order does not purport to determine the just and reasonable rate for sales by small producers. See, also, *infra* pp. 15-16.

subject to the Act's just and reasonable standards, there would have been no occasion for the inclusion in Order No. 428 of the indirect regulatory scheme. As noted by the Court below (Pet. App. 14a):

> "* * * It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards."

2. The Commission's actions flaunt the Congressional limits upon its authority. The Act expressly provides for *all* wholesale sales of natural gas to be subject to its substantive rate provisions and leave no room for Commission exemption from this "heart of the * * * regulatory system" (*F.P.C.* v. *Hope Natural Gas Company,* 320 U.S. 591, 611, (1944)). Thus, Section 1(b), App., *infra,* p. 1a provides for the Act to "apply * * * to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial or any other use * * *."[11] Section 4(a), App., *infra,* p. 1a, prescribes in pertinent part:

> "*All* rates and charges made * * * by *any* natural gas company * * * and *all* rules and regulations affecting or pertaining to such rates * * * shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful." (Emphasis supplied.)

[11] Section 1(c), added in 1954, 68 Stat. 36, 15 U.S.C. 717(c), contains a limited exception not here applicable.

And Section 5(a) App., *infra,* pp. 1a-2a, provides:

> "Whenever the Commission, after a hearing * * * shall find that *any* rate, charge, or classification demanded, observed, charged, or collected by *any* natural-gas company in connection with *any* transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that *any* rule, regulation, practice, or contract affecting *such* rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order * * *". (Emphasis supplied.)

In line with these "flat and unqualified" rate provisions of the Natural Gas Act (*cf. American Trucking Associations* v. *F.C.C.,* 377 F.2d 121, 130 (D.C. Cir., 1966), *cert denied,* 386 U.S. 943 (1967)), it has been recognized and accepted since at least this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954), that:

> "* * * the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during or after transmission by an interstate pipeline company." (347 U.S. at 682). (Emphasis supplied.)

In that case, which involved the question of the Commission's jurisdiction over producer sales generally, this Court went on to say (*Id.* at 682-684):

> "There can be no dispute that the overriding congressional purpose was to plug the 'gap' in regulation of natural-gas companies resulting from judicial decisions prohibiting, on federal constitu-

tional grounds, state regulation of many of the interstate commerce aspects of the natural-gas business." [fn. omitted] "* * * Thus, we are satisfied that Congress sought to regulate wholesales of natural gas occurring at both ends of the interstate transmission systems."

See, also, *F.P.C.* v. *Southern California Edison Co.,* 376 U.S. 205, 216 (1964); *Saturn Oil & Gas Company, Inc.* v. *F.P.C.,* 250 F.2d 61, 67 (10th Cir. 1957), *cert denied,* 355 U.S. 956 (1958) (holding that "* * * there is nothing in the Natural Gas Act which makes its applicability depend on the size or the integration of the gas operation".); *Deep South Oil Company of Texas* v. *F.P.C.,* 247 F.2d 882, 887 (5th Cir. 1957) (holding sales of natural gas by "a small unintegrated corporation" to be subject to regulation under the Act); cf. *Commission Order No. 174-B,* 13 FPC 1576, 1577 (1954).

3. Nor does Section 16, App., *infra,* p. 2a, vest authority in the Commission to ignore or even modify the clear mandate of Sections 4 and 5. However broad and sweeping may be the power vested in the Commission by that Section, it plainly was not intended to delegate to the Commission authority to revise or modify the coverage as explicitly prescribed by Congress in other provisions of the Act.

This Court has not given Section 16 any broader construction. In *F.P.C.* v. *Louisiana Power & Light Co.,* 406 U.S. 621 (1972) relied on by the Commission (Pet. p. 11), this Court first determined that Section 1(b) included authority for the Commission to control curtailments before it invoked Section 16 as a basis for its holding that the Commission has "broad powers to

devise effective means to meet these responsibilities." (See 406 U.S. at 636-642).

Likewise, the special classification for small producers which this Court approved under Section 16 in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) (also relied on by the Commission (Pet. pp. 4, 11, 13)) related to the rule making proceeding directed at relieving small producers from the burdens of complying with certain filing and reporting requirements.[12] This special classification, however, did not extend to exempting small producers generally from the area rates there fixed for the Permian Basin.[13] To the contrary, small producer rates still remained subject to the Act's just and reasonable rate standards and this Court specifically noted that "the exemptions created by the Commission" were "fully consistent with the terms and purposes of its statutory responsibilities" (See 390 U.S. at 787). As stated by the Court below with reference to Section 16 (Pet. App. 10a):

> "The Commission can only classify '[f]or the purposes of its rules and regulations.' It can only prescribe rules and regulations 'to carry out the provisions of this chapter.' Section 16 thus does not give the Commission independent powers.

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[12] Contemporaneously with the litigation in *Permian,* the Commission went ahead with that rule-making proceeding. As a result, and prior to, and independently of, Order No. 428, the Commission issued Order No. 308, 34 FPC 1202 (1965). See, *supra,* p. 10.

[13] The sole exception to the complete applicability to small producers of the area rates established in *Permian,* was the so-called quality adjustment provisions. However, this Court's affirmance of that exception was based on a finding that its effect was *de minimis.* See 390 U.S. at 786.

Rather, it provides for implementation of the core sections of the Act, such as Section 4.'"[14]

Moreover, the holding below is not contrary to this Court's further observation in *Permian* (390 U.S. at 795) with regard to the relevancy of market prices in the fixing of just and reasonable area rates (see Pet. p. 13.)[15] As noted *supra*, pp. 4, 10, the rationale underlying Order No. 428 is that the statutory standards are inapplicable since the Commission has exercised its discretion to waive compliance—not that market prices comply with these standards. Order No. 428 contains no finding that the prices in small producer contracts (which the order would allow to be charged) are just and reasonable. Nor would the Commission validly make any such finding. Not only was Order No. 428 issued without evidentiary hearing or record, but it would grant blanket advance authorization to small producers wherever located to charge whatever prices they might thereafter be able to negotiate with their purchasers. Since there is no inherent correlation,

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[14] The suggestion of Mr. Justice Clark in *F.P.C. v. Hunt*, 376 U.S. 515, 527 (1964), also cited by the Commission (Pet. p. 4) was pure dictum. Moreover, the situation of the National Labor Relations Board there referred to is not in fact analogous; in contrast to the flat, unqualified mandate of the Natural Gas Act, the National Labor Relations Act expressly vests broad discretion in the Board whether to exercise its jurisdiction. See, *e.g. Guss v. Utah Labor Relations Board*, 353 U.S. 1, 13-14 (1957) (Mr. Justice Burton dissenting).

[15] The Court's observation thus cited by the Commission does not constitute a holding that market prices might be relevant in appropriate circumstances to establishing just and reasonable area rates. Rather, the Court there only noted the existence of the question and expressly refrained from passing on it.

much less identity, between market prices and regulated just and reasonable rates (*cf. F.P.C.* v. *Hope Natural Gas Co.,* 320 U.S. 591, 601 (1944), the Commission's *a priori* advance and sweeping approval of small producer contract prices could not be grounded on an application of the just and reasonable standard.

4. Finally, the indirect regulation of small producers proposed by the Commission is not an effective substitute for the direct regulation explicitly provided in the Natural Gas Act. In addition to reopening a regulatory gap which Congress and this Court thought had been closed by the Natural Gas Act, the standard which the Commission proposes to apply in determining whether to allow the small producers prices as costs to the purchasers is not the "just and reasonable" standard provided in the Act but rather a standard based on whether that price is

> "* * * unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing areas."

These alleged criteria suffer from the further infirmity that they are vague and hence fail to provide the requisite guidelines to the purchasing pipeline or large producer in evaluating the risks incurred in agreeing to pay a particular price to a small producer.

Had Congress shared the Commission's present views as to the effectiveness of such indirect regulation, there would have been no occasion to enact the Natural Gas Act or Federal Power Act; there would have been no "gap" disclosed by *Public Utilities Commission* v. *Attleboro Steam and Electric Co.,* 273 U.S. 82 (1926)

since the local regulatory agencies clearly had the authority to disallow imprudent or excessive payments made by the local utilities subject to their jurisdiction. Similarly, had this Court shared these Commission views, there would have been no occasion for it to rule in ***Phillips Petroleum Co.* v. *Wisconsin***, 347 U.S. 672 (1954) that independent producers were subject to direct regulation under the Natural Gas Act, since the Commission already had the authority to disallow any imprudent or excessive payments for gas made by the pipeline companies to such producers.[16]

Patently, therefore, neither Congress nor this Court regarded the "indirect regulation" now urged by the Commission as providing adequate and comprehensive regulation. To the contrary, as this Court has repeatedly held, Congress, in enacting the Natural Gas Act, rejected such indirect regulation as creating a regulatory gap. Accordingly, Congress provided for the elimination of that gap by subjecting all wholesale sales of gas to direct regulation under the Act and requiring the rates charged for all such sales be just and reasonable. The Commission's proposal in Order

[16] The Commission's claim, that the small producer sales (which it computed as 10% of all 1969 pipeline purchases) is *de minimis*, is inconsistent with its earlier determination in *Permian Basin Area Rate Cases*, 34 F.P.C. 159, 235 (1965) that such gas represents 15% of the aggregate interstate gas supply "and is a substantial factor in the cost of the gas supply of millions of American consumers."

Moreover, the 10% figure itself is suspect. As an average, it minimizes the magnitude of the small producer purchases made by a number of pipelines. (cf. *Permian Basin Area Rate Cases*, *supra* at 235). In addition, it admittedly does "not include resales to pipelines by large producers of gas purchased from small producers" (Pet. App. 32a, fn. 1), whereas the record shows such resales in fact to be very substantial (R. 113, 130-131).

No. 428 is contrary to both the Congressional intent in enacting the Natural Gas Act and this Court's understanding in deciding the *Phillips* case, *supra.*[17]

## CONCLUSION

For the foregoing reasons it is respectfully submitted that the petitions for writ of certiorari should be denied.

Respectfully submitted,

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June, 1973

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[17] Even if viewed as an experiment as urged by the Commission (Pet. p. 12), the assurance provided in Order No. 428 that small producer contracts "will not be subject to change" (Pet. App. 31a) points to inevitable long-term consequences. Natural gas contracts typically are for 20 or more years. Cf. *United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 338-339 (1956). See also Pet. App. p. 15a.

## APPENDIX

The Natural Gas Act, 52 Stat. 821, 15 U.S.C. 717 *et seq.* provides in pertinent part as follows:

NECESSITY FOR REGULATION OF NATURAL-GAS COMPANIES

SECTION 1. * * * (b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

* * *

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * *

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

SEC. 5. a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-

gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates. z

* * *

ADMINISTRATION POWERS OF COMMISSION; RULES, REGULATIONS, AND ORDERS

SEC. 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission

shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972

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No. 72-1490

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FEDERAL POWER COMMISSION,
*Petitioner,*

v.

TEXACO INC., *et al.*

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**On Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## MEMORANDUM FOR CONSOLIDATED GAS SUPPLY CORPORATION

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Consolidated Gas Supply Corporation (Consolidated), an active participant in the administrative proceedings below and an Appellant in the subsequent review proceedings in the District of Columbia Circuit Court of Appeals, hereby notifies this honorable Court that it does not oppose the Government's Petition for Writ of Certiorari filed in these proceedings but reaffirms its opposition to the Federal Power Commission's policy (announced in Order Nos. 428, 428-A and 428-B)[1] of indirectly regulating rates for small independent producers through the review of purchase gas costs in the rate proceedings of the purchasing pipeline companies.

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[1] See 45 FPC 454, 45 FPC 548 and 46 FPC 47 (1971).

## STATEMENT

Consolidated[2] is a subsidiary of Consolidated Natural Gas Company, a public utility holding company, which owns and operates a large natural gas system engaged in all phases of the natural gas business, i.e., the production, purchase, gathering, transmission, storage and distribution of natural gas, as well as the extraction and sale of by-products.

Consolidated, its affiliated distributors and its nonaffiliated distributor customers render gas service in West Virginia, Ohio, Pennsylvania and New York. As of 1972, Consolidated supplied gas for more than two million domestic, commercial and industrial customers located in over 1,500 cities and towns having a population of more than 10,500,000. In addition, Consolidated provides substantial gas storage services for a number of gas distributors in the Northeast.

The bulk of the Consolidated System's gas supply (75%) is obtained from six interstate pipelines, but an important part of the System's supply is purchased from independent producers operating in the Appalachian Area. In 1972, purchases from Appalachian sources accounted for approximately 13% of the System's total supply.

Consolidated shares the Commission's concern for the nation's critical gas supply shortage. Until the fall of 1968, the Consolidated System experienced no difficulty in obtaining the additional new supplies that it required. Since then, however, Consolidated has been unable to purchase any additional firm, flowing supplies of natural gas on a long-term basis, despite continuous efforts to acquire such additional supplies. Indeed, three of the Consolidated System's pipeline suppliers are currently unable to deliver the full annual volumes of natural gas required by their sales contracts. As a consequence, Consolidated and its distributor customers were forced early in 1970 to adopt a sales policy which prohibited

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[2]Consolidated is a *natural-gas company* within the meaning of the Natural Gas Act [52 Stat. 821 (1938); 15 USC § 717(b), *et seq.*] and, as such, its rates and charges for sales made in interstate commerce for resale are subject to regulation by the Commission.

the attachment of any new industrial or large commercial loads, and the sale of additional gas to existing industrial customers for use in new processes.[3]

Faced with the declining availability of domestic supplies, the Consolidated System has embarked on an aggressive program to obtain supplemental supplies from nonconventional sources, such as the importation of substantial quantities of LNG from Algeria and the importation of natural gas from Canada. However, the acquisition of nonconventional supplies cannot alone provide the answer to its supply problem. If the Consolidated System is to meet the requirements of its customers, it is essential that an economic climate be created that will encourage domestic producers to search for, develop, and produce large quantities of new domestic supplies.

Throughout the administrative and Court proceedings below, Consolidated consistently took the position that sales by small producers in interstate commerce should be subject to the applicable area ceiling rate fixed by the Federal Power Commission and that, if the area rates were too low to elicit adequate levels of supply, the Commission should, accordingly, make an adjustment in the ceiling price. The domestic supply picture has continued to deteriorate in the year that has elapsed since Consolidated filed briefs in the Court Proceedings below and it is now apparent that extraordinary actions are required to reverse the trend of rapidly diminishing domestic supplies. Consolidated shares the government's view that (Petition, p. 13):

> "Under present conditions, the Commission determined that reliance on the market mechanism

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[3]Even more restrictive sales policies have been imposed on the Consolidated System's wholesale customers operating in New York and Pennsylvania by the New York Public Service Commission and Pennsylvania Public Utility Commission, respectively. See Orders issued October 26 and December 16, 1971, in New York Commission Case No. 25,766, and February 1, 1972, in Pennsylvania Commission Investigation Docket No. 124.

would encourage the highly competitive small producers to explore for new supplies of natural gas and would result in just and reasonable rates in the best interests of consumers."

Further, an examination of the Commission's regulatory policy for the Appalachian Area,[4] where small independent producers have always accounted for a significant part of the gas discovered and produced in the Appalachian Area, disclose additional problems. The Commission has acknowledged that the area rates fixed for the Appalachian Area are not high enough to provide small producers with an adequate incentive to explore for new Appalachian reserves.[5] Nonetheless, the Commission elected not to increase ceiling prices for the area primarily because it could not be assured that higher rates would, in fact, elicit additional new supplies and because the Commission felt that its optional pricing procedures prescribed by Order No. 455, issued August 3, 1972 (37 F. R. 16189), would encourage small Appalachian producers to expand their efforts. But, it is now clear that Order No. 455 has not achieved the desired result in the Appalachian Area.

Nearly all of the independent producers operating in the Appalachian Area are extremely small – in many instances, one or two-man operations. They lack the technical expertise to make the type of filings required by the optional procedure. This, coupled with the expense entailed in such proceedings, has effectively prevented the optional pricing procedure from providing the desired stimulus for increased exploration by independent producers. In fact, Consolidated is unaware of *any* small producer operating in the Appalachian Area that has availed itself of the cumbersome and expensive optional pricing procedures established by Order No. 455 in the ten months that such procedures have been in effect.

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[4]The development of new Appalachian supplies is uniquely valuable to the consumers because of their close proximity to the highly ubanized northeastern markets and because of the potential development of new gas fields to storage pools.

[5]*Area Rates for the Appalachian and Illinois Basin Areas*, Opinion No. 639, issued December 12, 1972.

In the circumstances, Consolidated now believes that the Commission was fully justified in exempting small producers (particularly those operating in the Appalachian Area) from area ceiling prices and relying, instead, on market mechanisms to encourage small producers to explore for new domestic supplies of natural gas.

Consolidated continues to contend, however, that the Commission cannot legally regulate the rates charged by small independent producers by requiring purchasing pipelines to prove, in pipeline rate proceedings, the reasonableness of the price paid to small producers exempted from regulation under the Natural Gas Act. It is unfair to expose a pipeline which has contracted in good faith with an exempt producer, and which is obligated to continue paying the contract price, to the possibility of disallowance in a subsequent rate case of costs prudently incurred.

## CONCLUSION

WHEREFORE, Consolidated Gas Supply Corporation respectfully requests this Honorable Court to grant the petition for writ of certiorari.

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June 4, 1973

In the

# Supreme Court of The United States

OCTOBER TERM, 1972

No. 72-1490

FEDERAL POWER COMMISSION,
*Petitioner,*
*v.*
TEXACO, INC., et al.,
*Respondents.*

No. 72-1491

DUDLEY T. DOUGHERTY, et al., Co-Executors of the ESTATE OF MRS. JAMES R. DOUGHERTY, et al.,
*Petitioners,*
*v.*
TEXACO, INC., et al.,
*Respondents.*

*On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit*

## BRIEF IN OPPOSITION FOR RESPONDENT JAMES M. FORGOTSON, SR.

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## BRIEF IN OPPOSITION FOR RESPONDENT JAMES M. FORGOTSON, SR.

## PRELIMINARY STATEMENT

James M. Forgotson, Sr. is an independent producer of natural gas with production of natural gas in Louisiana and Texas. James M. Forgotson, Sr., a petitioner in the

court below, opposes the petitions for writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia circuit in the above-described proceedings.[1]

## QUESTIONS PRESENTED

Does the Federal Power Commission (FPC or Commission) have authority to exempt small producers from direct rate regulation and some other provisions of the Natural Gas Act by shifting the burden of establishing the justness and reasonableness of rates for interstate wholesale sales of natural gas from the seller (small producers) to the purchasers (interstate pipelines or large producers who buy natural gas from small producers for subsequent re-sale to interstate pipelines) despite clear statutory language to the contrary? If there is statutory authority for the above described scheme of indirect regulation does *any* price control scheme limited to just one energy source which is not unique constitute such invidious discrimination that it is abhorrent to the Fifth Amendment of the Constitution of the United States?

## STATEMENT

### A. Proceedings Before the Commission.

On July 23, 1970, the Federal Power Commission issued, in Docket No. R-393, a Notice of Proposed Rule-

[1] Reference is made herein solely to the petition of the Federal Power Commission, No. 72-1490, inasmuch as Dougherty, et al., No. 72-1491, does not raise any significant points not already covered by FPC.

making entitled "Exemption of Small Producers from Regulation" (R. 1-13). In essence, the Commission proposed to exempt small producers[2] from rate regulation under the Natural Gas Act, permitting them to collect contractually-negotiated prices for gas sold in interstate commerce for resale. The Commission undertook to assure small producers that their contract price would not be subject to change by the FPC and, therefore, they would no longer be subject to refund obligations. The Commission's stated purpose was to stimulate additional exploratory efforts and dedication of gas reserves to the interstate market in order to augment dwindling supplies. Its principle asserted authority for such was its classification powers under Section 16 of the Natural Gas Act (the Act).

The Commission did not propose to free small producers from all regulation under the Act, however, announcing that it would retain abandonment authority over small producers' sales pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b), as well as requiring certain annual reports. Further, the Commission proposed to allow pipelines to file "tracking" rate increases[3] to recover increases in their purchased gas costs which were anticipated as a result of exempting small producers from rate regulation.

After receiving comments from various parties, the

[2] "Small producers" are those producers selling 10,000,000 Mcf or less of natural gas in interstate commerce for resale annually.

[3] "Tracking" rate increases authorized by the FPC are similar in concept to the more familiar "fuel adjustment" clauses.

Commission issued Order No. 428 entitled, "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements" (FPC Pet., pp. 29a-46a).[4] The Order, in general, followed the proposal indicated by the Commission's Notice of July 23, 1970, with respect to exempting small producers from rate regulation but, for the first time, the Commission indicated that the pipelines' right to "track" increases in purchased gas costs would be limited to that portion of the contract prices paid to small producers which the Commission, in later proceedings, found justifiable. The essence of the newly-announced *indirect* scheme of small producer rate regulation is set forth in the following excerpts:

> "The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers' sales." (FPC Pet., p. 32a).
>
> * * *
>
> "Any question as to the propriety of the price paid by a pipeline to a small producer will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified. The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas and to disallow

[4] Reference "FPC Pet." is to the Commission's Petition for Writ of Certiorari in No. 72-1490.

items of cost which are imprudent." (FPC Pet., p. 33a).

* * *

"Small producers will have no refund obligations with respect to increased rates . . . However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." (FPC Pet., p. 37a).

On July 15, 1971, the Commission issued Order No. 428-B (FPC Pet., pp. 50a-84a), which modified Order No. 428 in certain respects not at issue herein but reasserted the Commission's authority to engage in the unprecedented scheme of so-called indirect small producer rate regulation at the pipeline level.

## B. The Decision Below

The court of appeals, with one judge dissenting, set aside the Commission's action exempting small producers from rate regulation after concluding that such action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).

The court's decision turned upon an analysis of specific provisions of the Natural Gas Act, namely, Sections 4, 5, 7 and 16 (FPC Pet., pp. 85a-93a). The court concluded, in effect, that the regulation of rates for jurisdictional sales

was *mandatory*, and not discretionary or permissive, regardless of the size of the regulated entity. In that connection, the Commission's Section 16 classification powers would not permit the exemption of small producers from rate regulation under Section 4 of the Act (FPC Pet., pp. 7a-10a). That being the case, the court held that the Commission's Order Nos. 428 and 428-B represented a clear-cut abdication of statutory duty to assure that *all* regulated rates, including those of small producers, be "just and reasonable" (FPC Pet., pp. 10a-16a). This departure from statutory duty and standards through the so-called "indirect" mode of regulation at the pipeline level was held to be contrary to the provisions of the Natural Gas Act:

> "Nothing at all insures that those levels (of rates allowed to be passed on to consumers) will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a-13a).

## REASONS FOR DENYING THE WRITS

As will be shown below, the writs should be denied because: (1) the decision below is clearly correct as a

matter of statutory interpretation, (2) the decision below is clearly correct as a matter of constitutional law even if the court below erred in statutory interpretation in reaching its decision, and (3) there is no conflict of decisions to be resolved. The arguments of Independent Natural Gas Association of America (INGAA) dealing with the correctness of the decision below as a matter of statutory interpretation and absence of conflicts to be resolved presented in its brief in opposition (INGAA Brief In Opposition pp. 6-17) are correct and substantially complete and will not be repeated here. The only argument to be presented here is the Constitutional Argument.

**A. The decision below is clearly correct as a matter of Constitutional Law even if the Court erred in statutory interpretation in reaching its decision.**

When technologies and other circumstances change by reason of later events, statutes, including judicial interpretations of them, which were once Constitutional can become unconstitutional. *Abie State Bank v. Bryan (Weaver)* 282 U.S. 765 (1931). It is the contention of Respondent Forgotson that because of changes in science and technology, natural gas itself is not a unique fuel or energy source. It merely is an energy yielding commodity which when consumed produces a given amount of energy per unit of mass or volume. There is nothing unique about the production, shipment and storage of natural gas. There is no economic, technological, administrative or other valid reason for classifying natural gas and *any* independent producers

thereof to justify imposition of price controls and other public utility regulations of independent field producers. These producers are not public utilities. What has happened has been the creation of a closed class of field producers of other fossil and nuclear fuels plus producers of synthetic molecules of natural gas from coal, who are not subject to public utility regulation. The creation of a closed class constitutes invidious discrimination, *Morey v. Doud,* 354 U.S. 457 (1957). This discrimination is invalid under the due process clause of the Fifth Amendment of the Federal Constitution which incorporates the provisions of the Equal Protection Clause of the Fourteenth Amendment. *Brown v. Board of Education of Topeka,* 349 U.S. 294 (1955).

In addition there is a less restrictive alternative to dealing with potential monopolistic abuses by independent natural gas producers, namely vigorous enforcement of anti-trust laws. Consequently, the present over-all regulatory scheme should be constitutionally defective. See Streuve, *"The Less Restrictive Alternative Principle and Economic Due Process"*. 80 Harv. L. Rev. 1463 (1967). See also, Areeda, *Antitrust Analysis* (1st ed. 1967).

Respondent Forgotson contends that the classification of independent producers as "natural gas companies" under the Natural Gas Act in *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672 (1954), making said producers subject to public utility regulation by the FPC is no

longer justifiable constitutionally; therefore all regulation under the Act of independent producers, whether large or small, is unconstitutional and Orders 428 and 428-B must be invalidated.

## CONCLUSION

The petitions for Writ of Certiorari should be denied.

Respectfully submitted,

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

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BRIEF OF DUDLEY T. DOUGHERTY, ET AL.

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## OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A, pp. 1a-22a)1/ is reported at

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1/"Pet. App." refers to the Appendix to the petition for a writ of certiorari of the Federal Power Commission in No. 72-1490. "App." refers to the separately-bound joint appendix in this Court.

474 F.2d 416. The initial order (No. 428) of the Federal Power Commission (Pet. App. D, pp. 29a-46a), its order (No. 428-A) of amendment (Pet. App. E, pp. 47a-49a), and its order (No. 428-B) denying rehearing (Pet. App. F, pp. 50a-84a) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47 respectively.

## JURISDICTION

The judgment of the court of appeals was entered on December 12, 1972 (Pet. App. B, pp. 23a-25a) and timely petitions for rehearing were denied on February 5, 1973 (Pet. App. C, pp. 26a-28a). The petitions for writs of certiorari were filed on May 3, 1973, and were granted on October 9, 1973. The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTION PRESENTED

Whether the Federal Power Commission has authority to exempt small producers from certain filing requirements under the Natural Gas Act, 15 U.S.C. 717, et seq., and to regulate the interstate wholesale sales of such small producers indirectly through review of the costs to large producers and interstate pipelines of purchasing gas from small producers.2/

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2/ This statement of the question is essentially the question presented in the petition in No. 72-1490, and is a narrowing of, but covered by, the question presented in the petition in No. 72-1491.

## STATUTES INVOLVED

Sections 4, 5, 7 and 16 of the Natural Gas Act, 15 U.S.C. 717c, 717d, 717f, and 717o, are set forth at Pet. App. G, pp. 85a-93a.

## STATEMENT

This case arises from orders issued by the Federal Power Commission in a rule-making proceeding relieving "small producers" -- producers with jurisdictional sales of less than ten million Mcf of gas per year -- from certain regulatory burdens, and regulating the interstate wholesale sales of gas by small producers indirectly. The court below held that the Commission's orders exceeded its authority under the Natural Gas Act and set them aside.

1. In 1954, this Court held in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, that the Commission has jurisdiction under the Natural Gas Act (15 U.S.C. 717, et seq.) to regulate well-head sales by producers of natural gas to interstate pipelines. Producers thus became subject to the requirements of the Act, including the certification procedures under Section 7(c)(15 U.S.C. 717f(c)), the contract filing procedures under Section 4(d) (15 U.S.C. 717c(d)), and the requirement under Section 4(a) (15 U.S.C. 717c(a)) that all rates and charges be "just and reasonable."

Following the Phillips decision, the Commission at first attempted to regulate producer sales on a traditional, individual basis. This method of regulation proved

thoroughly impractical, and in 1960 the Commission instituted area rate proceedings to determine maximum producer rates for each of the major producing areas. See Permian Basis Area Rate Cases, 390 U.S. 747, 755-758 (1968). Although the Commission now has determined an area rate for each major producing area, the area rate proceedings have proved to be enormously complex. In order to reduce the complexity, the Commission has relied on its authority under Section 16, 15 U.S.C. 717o, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

This Court has encouraged the Commission to use this statutory authority to exempt small producers from certain provisions of the Act, first by Mr. Justice Clark in dissent (Wisconsin v. Federal Power Commission, 373 U.S. 294, 329-330 (1963)) and later reiterated by him speaking for the Court (Federal Power Commission v. Hunt, 376 U.S. 515, 527 (1964)). The Commission followed these suggestions in its first area rate proceeding and exempted small producers from various filing requirements under Sections 4 and 7 of the Act. 34 FPC 234, 235. On review, this Court sustained the Commission's separate treatment of small producers; it held (Permian Basin Area Rate Cases, supra, 390 U.S. at 787):

> We conclude that these arrangements did not exceed the Commission's statutory authority. We recognize that the language of §§5 and 7 is without exception or qualification, but it must also be noted that the Commission is empowered, for purposes of its rules and regulations, to

> "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." §16, 15 U.S.C. §717o. The problems and public functions of the small producers differ sufficiently to permit their separate classification, and the exemptions created by the Commission for them are fully consistent with the terms and purposes of its statutory responsibilities. It is not without relevance that this Court has previously expressed the belief that similar arrangements would ameliorate the Commission's administrative difficulties. See F.P.C. v. Hunt, 376 U.S. 515, 527. [Emphasis supplied.]

Recently the Commission, in addition to trying to deal with the problem of how effectively to regulate the thousands of natural gas producers, also has had to take into account the increasingly critical shortage of natural gas supplies. This shortage, which has been judicially recognized by this Court and the courts of appeals,[3] has seriously affected the ability of the Nation's major

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3/ See, e.g., Federal Power Commission v. Louisiana Power & Light Co., 406 U.S. 621, 626 (1972); Placid Oil Co. v. Federal Power Commission, 483 F.2d 880 (5th Cir. 1973); Public Service Commission for the State of New York v. Federal Power Commission, 467 F.2d 361 (D.C. Cir. 1972).

pipelines to meet the demands of their interstate markets. As a consequence, numerous curtailment proceedings -- of the type before this Court in Federal Power Commission v. Louisiana Power & Light Co., 406 U.S. 621 (1972) -- have been initiated before the Commission. It is in this context -- of immense complexities in regulating producer prices and of sharply rising gas shortages -- that the Commission's special treatment of small producers in this case should be reviewed.

2. In July 1970, the Commission initiated the proceedings involved here by issuing a notice of proposed rule-making proposing a regulation under which "small producers will be exempted from all provisions of the Natural Gas Act and the Commission's regulations otherwise applicable to the jurisdictional sales covered by such exemptions, except for the requirement that they submit annually a document setting forth their total volume of jurisdictional sales." 35 Fed. Reg. 12220. Although the proposed regulation was to apply to, and thus exempt from direct regulation, sales by small producers to large producers, the notice indicated that "resale of such gas by the large producer[s] would remain subject to [the] jurisdiction" of the Commission (ibid.), and that pipelines would be allowed to "track," or pass through, any price increases that resulted from the proposed regulation only if certain requirements were met. Seventy-three producers, pipelines, distributors and state commissions filed written comments (App. 135). After a conference between the interested parties and the Commission staff (App. 97-134), the Commission issued the orders in issue

here.4/

The Commission emphasized that "[o]ne of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market," and that in promulgating its rule it was "taking an important step to meet this responsibility" (Pet. App. D, p. 31a). Central to its decision was the growing national crisis resulting from a shortage of natural gas. While the demand for natural gas is increasing, the supply of newly discovered gas continues to drop. Net production reached an all time high in 1970, when 21.8 trillion cubic feet of gas were produced, but even then the supply of newly discovered gas, excluding the Alaskan discoveries, was dropping. The ratio of production to reserves had declined to 13.1 by 1969, to 11.91 by 1970 and to 10.5 by 1971. The more indicative findings-to-production ratio likewise was dropping and fell below 1.0 for the first time in 1968, and since then we have continued to use more gas than we have found. 1971 Annual Report of Federal Power Commission, at pp. 31-35; see City of Chicago v. Federal Power Commission, 458 F.2d 731, 746 n. 69 (D.C. Cir. 1971), certiorari denied, 405

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4/ On September 30, 1971 an adjudicatory hearing was held and on October 12, 1971 the small producers who had applied were issued blanket certificates. Less Hutt, d/b/a H & J Drilling Co., ___ F.P.C. ___ [No. CS 71-247]. The Commission has, however, continued the rule-making process involved here, and issued orders on April 10, 1972 (37 Fed. Reg. 9063) and May 4, 1972 (37 Fed. Reg. 9959) modifying the orders under review in this case.

U.S. 1074 (1972); Southern Louisiana Area Rate Cases, 428 F.2d 407, 437-455 (5th Cir. 1970), certiorari denied sub. nom. Municipal Distributor Group v. Federal Power Commission, 400 U.S. 950 (1970) (hereinafter referred to as Austral Oil Co.); Placid Oil Co. v. Federal Power Commission, 483 F.2d 880, 894-896 (5th Cir. 1973). There is, however, a tremendous volume of natural gas to be found. The best estimates are that 1,178 trillion cubic feet of probable, possible and speculative gas reserves are present in the United States. 1971 Annual Report of Federal Power Commission, at p. 34. But exploratory efforts to find this gas have dropped and continue to drop drastically; the number of exploratory wells resulting in natural gas discoveries decreased from 578 in 1966 to 481 in 1970. Ibid.

The small producers who are subject to the Commission's action here, have traditionally been and continue to be the most aggressive segment of the natural gas industry in exploring for more gas. See Permian Basin Area Rate Cases, supra, 390 U.S. at 785. Although they produce only 10.52 percent of the gas sold to interstate pipelines (Pet. App. D, p. 32a), they drill the great majority of all the exploratory wells drilled in the United States. 5/ As the Commission

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5/ Historically the small producers, who numbered 3,648 according to a recent Commission publication (Federal Power Commission, Sales by Producers of Natural Gas to Intestate Pipeline Companies 1969, p. XXI Table H), have been the most important source of exploratory drilling. For the

explained, its action in establishing the procedure for small producers involved here was intended to help alleviate the gas shortage (Pet. App. D, pp. 31a-32a):

> Such action should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas. Our purpose in taking action here is not to increase contract prices, but to

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calendar year 1970, smaller independents accounted for 57.6 percent of the exploratory successes -- both oil and gas. The Oil & Gas Journal, May 29, 1972, p. 10. The same group was responsible for 81.4 percent of the new gas field discoveries in 1971 (ibid.), and for 78 percent of the new gas field discoveries in 1972 (The Oil & Gas Journal, July 2, 1973, p. 11). Other sources indicate that in 1972 independents drilled 88.92 percent of the total exploratory wells (oil and gas), and 88.60 percent of the successful exploratory gas wells. Presentation by Petroleum Information Corporation to Honorable John A. Love, Director, Office of Energy Policy, August 30, 1973. This data includes the activity of independents who, although not major integrated petroleum producers, are not small producers within the definition of Order No. 428. It does indicate, however, the significant disparity between the drilling activities of the independents and of the larger integrated enterprises, such as the Chase Manhattan Bank's group of thirty major companies. Sparling, Anderson and Dobias, Annual Financial Analyses of a Group of Petroleum Companies (1972) (Chase Manhattan Bank Study).

> facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the administrative burdens connected with processing small producer filings.

The action taken by the Commission was to establish a system under which small producers will be automatically given a certificate of public convenience and necessity at the price fixed in their contracts, and hence will be allowed to collect that price without regard to the applicable area rates fixed by the Commission. While small producers thus have greater freedom, the Commission imposed limitations on the pipelines and larger producers who buy the small producers' gas. Their right to pass on the increase to their customers is restricted. First, the contract between the purchaser from the small producer and the purchaser's customers must permit passing on the increase. Second, the increase can be passed on only if it raises the purchaser's average cost of natural gas more than one mill per Mcf. Third, the purchaser must show that the price which it pays the small producer is consistent with present or future public convenience and necessity and also is reasonable. Some of the criteria for determining whether the price is reasonable are the "highest contract prices for sale

by large producers" and "the prevailing market price for intrastate sales in the same producing area" (Pet. App. D, p. 37a; see, also, id. at pp. 34a-35a). Thus any increase that a purchaser passes on to its customers will be subject to refund if found to be unreasonable (Pet. App. D, pp. 37a-38a).

Although under Order No. 428 small producers are not required to file for rate increases, pipelines and large producers are required to file annual reports (Pet. App. D, pp. 38a-39a). Certain small producer contract provisions that lead to rate increases -- favored nation, price redetermination and spiral escalation provisions -- are restricted so that the resulting rate will not exceed the applicable area rate (id. at pp. 32a-33a). And the Commission ruled that sales made by small producers can not be abandoned even if the contract expires, without Commission authorization pursuant to Section 7 (b) of the Act (id. at p. 39a); Pet. App. F, pp. 54a-55a).

The Commission expressly stated that its action was not "deregulation" of small producer sales (Pet. App. D, p. 32a). Such sales will be regulated indirectly through review of purchased gas costs in pipeline rate proceedings (ibid.) and through the other restrictions set forth above. Large producer and pipe line rates will be subject to reduction and refund to the extent that they are based upon small producer rates which are found to be unreasonably high. The Commission concluded that this reduction and refund obligation of large producers and pipelines should provide the necessary protection of consumer interests. In order to assure the certainty of the capital flow necessary to encourage exploration and development by

small producers, the Commission exempted small producers from any refund obligations (id. at pp. 37a-38a).

Finally, the Commission expressed its intention (Pet. App. D, p. 40a)

> * * * to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers.

In April 1971, the Commission issued Order No. 428-A (Pet. App. E, pp. 47a-49a) prescribing the form of the annual statement to be filed by small producers operating pursuant to the blanket certificate procedure thus established. In July 1971, the Commission issued Order No. 428-B (Pet. App. F, pp. 50a-84a) modifying Order No. 428 in certain respects and denying applications for rehearing.

3. On petitions for review,[6] the court of appeals, with one judge dissenting, set aside the Commission's orders establishing the blanket certificate procedure for small producers (Pet. App. A, pp. 1a-22a). The Court concluded that, by authorizing blanket

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6/ Petitioners in No. 72-1491 intervened in the court of appeals in support of the Commission.

certificates for small producer sales, the Commission had abdicated its statutory responsibilities under Sections 4 and 5 of the Act to insure that small producer rates will be "just and reasonable" (id. at pp. 10a-16a). The court rejected the Commission's contention that its action was a permissible classification under Section 16 of the Act on the gound that that section "does not give the Commission independent powers," but rather only power to implement "the core sections of the Act, such as Section 4" (id. at p. 10a). Nor, the court held, could small producer sales appropriately be regulated indirectly through the controls imposed by the Commission, since these were based on "factors which it does not regulate or which derive solely from market forces" (id. at p. 12a).

Judge Fahy dissented. In his view the only question before the court was "whether we can hold, on the record before us, that the type of regulation of prices adopted by the Commission has led or will lead inevitably to unjust or unreasonable rates charged by small producers to purchasers of gas from them * * *" (Pet. App. A, p. 19a). Citing this Court's recent decision in Federal Power Commission v. Louisiana Power & Light Co., 406 U.S. 621 (1972), he concluded (id. at pp. 19a-20a):

> The Commission has made a judgment which I think is within the ambit of its competence and expertise not to require small producers to be bound to the area rate and certain filing requirements, on an experimental basis. * * * The Commission is attempting to learn whether under this program the small producers, relieved of much

> of the burden of regulation required of other classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable, and which will not adversely affect the consumer interests protected by the Act. [Footnotes omitted.]

## SUMMARY OF ARGUMENT

Order No. 428 is a reasonable experiment by the Federal Power Commission to elicit critically needed natural gas. The Commission carefully weighed the interest of the consumer and temporarily determined that the necessary supply at the lowest price to him would be forthcoming if the small producer were permitted to receive the contract price, the variable field price, for natural gas.

Section 4(a) of the Natural Gas Act requires that all rates for the sale of natural gas be "just and reasonable". Nowhere does the Act expressly require a particular rate or preclude the Commission's reliance upon market mechanisms in determining what complies with the statutory standard. Indeed, consistent with this standard the Court has inculcated in the authority of the Commission the flexibility vital to its ability to resolve the complex problems of administrative delay and gas supply. In the evolution of the statutory standard this Court has suggested that the Commission could determine that market mechanisms would result in just and reasonable rates. Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

In this case the Commission followed this suggestion but carefully structured the market environment. It correctly reasoned that both the small producer's historical market position and the constraints that Order No. 428 imposed upon him and upon the pipelines and large producers who buy his gas provide sufficient protection to the consumer against unreasonably high prices. Predicated upon the small producer's small volume of sales but traditionally extensive exploratory efforts, the Commission reasonably concluded that the consumers would receive the maximum exploratory return for the minimum cost.

Although the prices received by small producers for their gas continue to be subject to review, the Commission concluded that they would not have any obligation to refund amounts previously collected if the Commission later determined that rates were too high. The Commission has broad discretion as to whether refunds under Section 4(e) are to be ordered, and it did not abuse its discretion in freeing the small producer from future refund obligations. The Commission correctly concluded that the threat of refund was detrimental to the degree of exploration it sought to elicit, and, on the balance, that the market mechanism defined under Order No. 428 would produce a just and reasonable rate.

## ARGUMENT

### THE NATURAL GAS ACT AUTHORIZES THE FEDERAL POWER COMMISSION TO REGULATE INTERSTATE GAS SALES OF SMALL PRODUCERS INDIRECTLY THROUGH REVIEW OF THE COSTS OF SUCH GAS TO PIPELINES AND LARGE PRODUCERS AND THROUGH MARKET FORCES.

The important question in this case is whether the Commission exceeded its authority under the Act in relying on indirect regulation and market forces to produce a just and reasonable rate for natural gas sales by small producers. The court below held that basing rates on market factors is the "antithesis of regulation" (Pet. App. A, p. 11a n. 18) and thus is not permissible under the Act. In doing so the court deprived the Commission of authority to make pragmatic adjustments in its regulatory procedures in order, consistently with its regulatory obligations, to help alleviate the critical shortage of natural gas which now concerns the Nation.

A. <u>The requirement of Section 4(a) of the Natural Gas Act that all rates for the sale of natural gas be "just and reasonable" does not require the Commission to set a particular maximum rate or preclude reliance on market mechanisms as a means of achieving just and reasonable rates</u>.

Since its initial construction of the Natural Gas Act this Court has recognized that although Congress provided no definition of the standard "just and reasonable," it was intended to imbue the Act with the flexibility vital to its effective administration. The Court indicated that no single legalistic formula could provide a solution

to the myriad of problems which would inevitably confront the Commission. Instead the Court emphasized the Commission's broad responsibility in rate-making to balance the consumer's right to receive gas at a reasonable rate to him with the investor's interest in maintaining the fiscal integrity of his venture. Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575, 586 (1942). The focal point of the "just and reasonable" concept was in preserving this balance. Since during those early years of administration under the Act there was a seemingly endless supply of natural gas, maintaining an adequate supply of gas was not an important element in the equation.

In Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1943) the Court further vitalized the concept of "just and reasonable" rates. The Court refused to permit the ossification of the administrative process, which it recognized would be the inevitable result should the validity of the Commission's determination of just and reasonable be contingent upon the empirical precision of its analysis. Conscious of the difficulties inherent in balancing the consumer and investor interests, the Court adopted the total effect standard for judicial review of a rate order (320 U.S. at 602):

> * * * Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. * * * It is not theory but the impact of the rate order which counts. If the total effect of the rate cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed

> to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.

On balance, the Court held that the Commission's use of a rate base to fix rates for Hope was not unreasonable. Hope, as have Respondents in this case, failed to demonstrate that the expert judgment of the Commission was unjust or unreasonable in its consequences. This case also brought forth additional considerations. The advent of the gas shortage in the Applachian Field where Hope produced and acquired its gas precipitated the injection of supply-incentive factors into the balance. The Court noted that if the rates were inadequate for development of new sources of supply, the Commission was authorized to make allowances therefor. 320 U.S. at 615. The injunction to the Commission was to fulfill the needs of the consumer at the minimum cost that would elicit an adequate supply.

The Court's decision in Hope was whether a particular rate -- a certain number of cents per Mcf -- was "just and reasonable" in the light of the expenses of the natural gas company -- its rate-base. But in Colorado Interstate Gas Co. v. Federal

Power Commission, 324 U.S. 581 (1941), the Court indicated that the Commission had the authority, although not the duty, to depart from the rate-base method of determining a just and reasonable rate. 324 U.S. at 601. The clear implication was that the Commission could and should do so in appropriate circumstances.

In the area rate proceedings the Commission looked to average expenses of all the companies to determine whether a rate was "just and reasonable" instead of the rate-base of a particular company. See Permian Basin Area Rate Cases, 390 U.S. 747 (1968). In addition, the Commission in these proceedings added non-cost factors to the balance. E. g., id. at 815. But until it issued Order No. 428 the Commission always had approved a particular rate ceiling as the "just and reasonable" rate. When the Commission had previously been invited by large producers and pipelines to approve a variable field price as either cost, expense or the producer rate itself, it justifiably refused to do so because of the impact on the consumer. This Court in Permian affirmed this refusal. 390 U.S. at 795.

However, the Commission's previous rejection of the concept of a fluctuating "just and reasonable" rate and the Court's approval of the rejection of such a concept in no way indicated that such a concept was forbidden by the simple phrase "just and reasonable", which is the only standard set forth in the Act. On the contrary, as early as Colorado Interstate Gas Co., v. Federal Power Commission, supra, 324 U.S. at 600-601, the Court indicated that had the Commission opted to permit the pipeline to include in operating expenses its gas production at the variable market price the Commission's

decision would not have been disturbed. And in Permian the Court, in again approving the Commission's rejection of variable or market based just and reasonable rates, admonished as follows (390 U.S. at 795):

> "We do not now hold, and the Commission has not suggested, that field prices are without relevance to the Commission's calculation of just and reasonable rates under §5 (a). The records in subsequent area proceedings may more clearly establish that the market mechanism will adequately protect consumer interests. We hold only that, on this record, the Commission was not compelled to adopt field prices as the basis of its computations of area rates." (Emphasis added.)

The Court has not intimated that the finding of a specific rate or even a certain price ceiling is the essence of the requirement that a rate be "just and reasonable." Such a rule would excise much of the Act's flexibility that the Court has so painstakingly developed. Instead, the essence is the attempt to provide the balance between the investor and the consumer interests, referred to in Natural Gas Pipeline Co. and in Hope. And if Order No. 428 reflects such a balancing of interests by the Commission and that balancing is not unreasonable or unjust, the Order must be sustained.

B. Order No. 428 is reasonably designed to result in a just and reasonable rate for gas sold by small producers.

Order No. 428 does not represent the simplistic idea that the market will in all events produce a just and reasonable rate for all natural gas. Rather it represents the Commission's decision that market prices in a particular, carefully-circumscribed market for a small portion of the industry[7/] can reasonably be expected to produce such a rate.

The rates that small producers will receive under Order No. 428 will vary in response to market factors in the particular market for their natural gas. The Commission promulgated its order in light of these factors and attempted to devise restrictions that

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7/ We believe there can be no question that the Commission acted properly in classifying the small producers for the experiment provided under Order No. 428. Section 16 of the Act (15 U.S.C. 717o) empowers the Commission, for purposes of its rules and regulations, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." This Court in Permian relied squarely on Section 16 in sustaining the Commission's special treatment of small producers (390 U.S. at 787). See also, Federal Power Commission v. Louisiana Power & Light Co., supra, where the Court emphasized that Section 16 assures the Commission in administering the Act "the necessary flexibility" to make the pragmatic adjustments required by particular circumstances (406 U.S. at 642).

would tend to provide consumers added protec- tion against unreasonably high prices. Firs the vast majority of the natural gas that reaches the interstate market is sold pursua to contracts negotiated many years ago in the era when rates for natural gas were low.8/ Those contracts are generally long-term, ofte for the life of the field where the gas is produced, and under Order No. 428 those con- tracts are going to continue in effect; Orde No. 428 itself precludes any abandonment of of gas heretofore or hereafter dedicated to interstate commerce. Thus although a small producer's contract may expire, he is obliga to continue selling the jurisdictional gas t the purchaser under the old contract, and at the area rate unless that purchaser agrees t pay a greater price, which he has no reason do. See Pet. App. D, p. 36a n.4.9/

Second, the Commission proscribed certain market practices that might lead to unreason- ably high prices. Favored nation, price re- determination and spiral escalation clauses in small producer contracts are not effectiv to the extent they result in prices above the applicable area rate.

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8/ As of January 1, 1974, 62 percent of all jurisdictional gas will be sold pursuant to contracts with fixed prices below area rate ceilings. Foster Associates, Inc., The Impact of Deregulation on Natural Gas Prices, p. 4 (August 1973).

9/ The small producer is barred from making any unilateral rate increases. See, e.g., United Gas Pipe Line Co. v. Mobile Gas Servic Corp., 350 U.S. 332 (1956).

Third, market constraints on the small producers' rate bargaining ability exist and were considered by the Commission as viable and productive of a cost to the consumer commensurate with the exploratory benefits likely to result. The small producers are just that -- small. Although they account for the bulk of all explorations for new natural gas supplies, their gas sales constitute a relatively small percentage of the total sales in interstate commerce.[10/] Large producers and pipelines account for the balance of such sales. And the more than 3600 small producers generally have to sell their gas to a large producer or a pipeline, whose bargaining power is dominant compared with that of the small producer.[11/] The individual small

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10/ The sales for 1970 and 1971 were respectively 11.2 and 11.1 percent of the total volume. Federal Power Commission, Sales by Producers of Natural Gas to Interstate Pipeline Companies 1970, p. XXI Table H; Federal Power Commission, Sales By Producers of Natural Gas to Interstate Pipeline Companies 1971, p. XXII Table H. These figures are in line with the Commission's estimate of 10.52 percent based on its 96-company sample (Pet. App. D, p. 32a).

11/ See Douglas, "The Case for the Consumer of Natural Gas," 44 Geo. L. J. 566, 579-580 (1956); Diener, "Area Price Regulation in the Natural Gas Industry of Southern Louisiana," 46 Tul. L. Rev. 695, 721 (1972). Indeed, large producer market concentration is extreme; four companies hold approximately 50 to 75 percent of all available reserves. Statement of Lee C. White, Chairman of the Energy Policy Task Force, Consumer Federation of America, before the Senate Commerce Committee, October 25, 1973, at p. 7.

producer who discovers gas is not in a position to withhold it from the market, and to pay the completion expenses and shut-in royalty that would result, until he can get a higher price. Moreover, the bargaining disadvantage the small producer faces is increased by the limits on the types of operations he can conduct.

The small producer basically has two options. He can farm-out -- sublease as lessee -- a small portion of acreage from a large tract that a large producer has under lease. Typically the large tract will be mostly unexplored, however, and the small producer will be allowed to share only in the production that he discovers and, if he is successful, to develop some acreage adjacent to the discovery well, perhaps enough for several more wells. The large producer will then proceed to develop the rest of the field. In such a situation the small producer must sell at the same price as the large producer who owns the field; there is no reason for a purchaser to pay a higher price to the small producer since his gas can simply be drained away by the large producer who is producing gas all around him.

The small producer's second option is to engage in wildcat operations in areas that are mostly unleased and concerning which there is little geophysical and exploratory data. These unleased areas are usually far removed from any existing pipeline. By drilling such wildcat wells he is performing the exploratory function for which he has become the recognized leader in the industry. But if he finds gas, there is no market for that gas until enough successful wells are drilled to establish that there is enough gas to attract a pipeline into the area. He has no revenue until he obtains a pipeline

connection. And when this occurs he either must agree to sell to the pipeline at a price largely determined by it, or again be faced with paying shut-in royalties and other expenses without any income. Thus both methods in which the small producer conducts his drilling operations -- the farm-out and the wildcat -- place him at a serious competitive disadvantage.

Finally, the Commission did not rely solely on existing market forces to protect customers against paying unreasonably high prices to the small producer. Order No. 428 added to the existing market conditions additional protection by encouraging the customers of small producers to bargain hard in connection with the purchase of newly discovered gas. It imposed restrictions on the ability of the large producers and pipelines to pass through to their consumers rate increases paid to the small producers. They cannot pass through any increase until the total increases raise the average cost of gas of the particular pipeline or large producer at least one mill per Mcf. And they will not be allowed to pass through increases if the rate paid to the small producer is unreasonably high.

2. Order No. 428 thus reflects an effort by the Commission to establish a system of variable prices based on a very special, limited circumstance. In this context, we submit, the Commission can reasonably anticipate that the prices received by small producers will be "just and reasonable". While there is nothing inherent in Order No. 428 that will require the prices that small producers receive to rise, it is obvious that in view of the present critical shortages the prices small producers will receive under this system will be higher than the prices that were being received before the order was issued. The

Commission was aware that the prices likely would increase, but it was trying to create a system where the increased price would result in a reasonable rate and at the same time provide a meaningful incentive to increase exploration activity and the supply of natural gas.12/ In doing so the Commission sought to use price functionally as a tool to elicit additional supply, as it clearly is entitled and indeed obligated to do. See, e.g., Permian Basin Area Rate Cases, supra, 390 U.S. at 798-801. Moreover, the Order will enable prices to be set and adjusted without the necessary administrative delays inherent in the rate-base and fixed-price regulation system.

Prices for small producer gas thus will be allowed to fluctuate with the supply of gas, in the open market but subject to the controls established by the Commission. Mr. Justice Jackson, concurring in Colorado Interstate, advocated just this sort of

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12/ The Commission's recent efforts to increase the supply of natural gas by providing higher gas prices, through increased rates for the small producers under Order No. 428 and for interstate gas generally, in combination with higher prices for intrastate gas, have markedly affected the exploratory drilling effort. Exploratory drilling increased 16 percent for the first six months of 1972, and is estimated to have increased 32 percent for the entire year. See XLIII Petroleum Independent, Sept.-Oct. 1972, at p. 5; The Oil & Gas Journal, July 2, 1973, at p. 10. Apparently the same trends have occurred in 1973. See The Oil & Gas Journal, November 5, 1973, at p. 105.

regulation (324 U.S. at 612):

> Far-sighted gas-rate regulation will concern itself with the present and future, rather than with the past, as the rate-based formula does. It will take account of the conditions and trends at the source of supply being regulated. It will use price as a tool to bring goods to market -- to obtain for the public service the needed amount of gas. * * * The problem, of course, is to know what price level will be adequate to perform this economic function.

The Commission has tried this on an experimental basis using the indirect system of regulation under Order No. 428 for only the small producer segment of the industry, in an effort to achieve the ideal price to which Justice Jackson referred

While the Commission delineated neither the effect that Order No. 428 would have on the exploratory activities of the small producer nor the effect it would have on the gas price to the ultimate consumer, sufficient public data exist from which plausibly to estimate these effects.13/ Of course, "the impact of an

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13/ The data are set forth in Foster Associates, Inc., The Impact of Deregulation on Natural Gas Prices (August 1973), and in Federal Power Commission, Sales by Producers of Natural Gas to Interstate Pipeline Companies 1971, Tables A and H. The calculation is as follows: The average revenue per Mcf for all natural gas sold to interstate pipelines in 1971 was 19.65 cents. The price of 62 percent of such gas is fixed below area rate ceilings (note 8, supra, p. 22), so only 38 percent of such gas is subject to any

increased rate upon the consumer results only from the average price paid by the pipeline for all of its gas, and the amounts of gas sold by small producers do not substantially affect the results as a whole." Permian Basi Area Rate Proceedings, 34 FPC 159, 361 (1965) As concerns gas already dedicated to the inte state market under existing contracts, if it is assumed that a maximum increase will occur the funds thus generated would enable the small producers to drill 3,000 additional exploratory wells 7,000 feet deep each year. The maximum increase to provide these funds would increase the residential consumer's annual bill only 6 percent. These estimates further support the Commission's regulatory scheme under Order No. 428, and the experiment should be given an opportunity to work.

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increase. The small producers accounted for approximately 11.1 percent of sales by all producers; multiplying this by the total natural gas subject to a price increase, the maximum amount of natural gas subject to possible price increase to the small producers by reason of Order No. 428 would be 615,736,0 Mcf. Assuming that the average gas price received by the small producer under Order No. 428 will increase fourfold -- from 19.65 cents to 78.6 cents -- and that this increase will be absorbed solely by residential consumers, who total approximately 39,416,000, their average annual gas bill, now at $155, would increase by $9.20, or 6 percent. As we point out in our argument, the likely price increase will be much less than fourfold because the market as it exists and as structured under Order No. 428 will not permit it. Moreover, while we have assumed here that the entire burden of the increase would fall on the residential consumer, in actuality any increase resulting under Order No. 428 will be

3. The court of appeals was particularly troubled by the two factors mentioned by the Commission as relevant to determine whether prices paid small producers by large producers and pipelines are unreasonable. It stated that it was improper to look to the highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the area, since the Commission did not directly control these factors. But this is only part of the scheme used in Order No. 428. And the issue in this case is not whether any one element in the overal scheme is beyond the Commission's control or whether the rates received by the small producers' customers are just and reasonable. The issue is whether the Commission acted unreasonably

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borne by the industrial user as well.

The beneficial impact of Order No. 428 on the small producers' ability to conduct exploratory efforts will be significant. The per foot dry hole costs (the cost simply to determine if any gas exists) is approximately $16.02. The Oil Producing Industry in Your State, at p. 99 (1973). Based on the assumed price increase stated above and the increased revenues to small producers that this would generate, small producers would have additional funds available to drill approximately 22 million feet of gas well tests. This amount of additional exploratory effort would provide approximately 13 percent of the total 1973 exploratory activity recommended by the Commission's staff to achieve a proper level of supply. See Federal Power Commission, Staff Report on National Gas Supply and Demand, at p. 34 (1969).

in concluding that the entire system of small producer pricing established in Order No. 428 will produce just and reasonable rates for small producers, with an appropria balancing of the interest of the public to have an adequate supply of gas, the interest of the consumer to buy gas at the lowest rea sonable rate and the interest of the investo to have a fair return on investment. Federa Power Commission v. Hope Natural Gas Co., supra, 320 U.S. at 602-603.

Moreover, even these announced criteria are within the Commission's authority. This Court has approved the Commission's consideration of negotiated prices as an important element in arriving at an area rate. Permia Basin Area Rate Cases, supra, 390 U.S. at 795 n. 67. The Commission stated here that in reviewing the pipeline rates, it would consider all relevant factors, not just the intrastate market price and the large producer contract prices. And it is obvious that where there is competition between inte state and intrastate markets, the Commissio must be allowed to consider intrastate price so that the interstate market can compete for the gas.14/ Placid Oil Co. v. Federal

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14/ Nor is there any reason to assume that the consideration of intrastate rates will inevitably result in excessive rates. In Other Southwest Area Rate Cases, 5th Cir., No. 72-1114, decided June 8, 1973, slip op. at p. 19, the court noted "A careful examina tion of intrastate rates shows that the 'nev gas rates established [by the Commission] * * * exceed the weighted average of current intrastate sales in every sub-area except Other Oklahoma."

Power Commission, supra, 483 F.2d at 905; In re Hugoton - Anadarko Area Rate Case, 466 F.2d 974, 989 (9th Cir. 1972). Finally, comparison of small producers rates to those of intrastate sales and highest large producer contracts is little more than consideration of a non-cost factor, like those which the Commission has included, and this Court has approved, in determining just and reasonable rates. Permian Basin Area Rate Cases, supra, 390 U.S. at 815; see also, Austral Oil Co., supra, 428 F.2d at 425-427.

C. The Commission acted properly in stating that small producers will have no refund obligation for rates collected pursuant to Order No. 428.

The court of appeals expressed concern that under Order No. 428 the Commission had abandoned any future review of small producers rates (Pet. App.A, p. 12a n. 21). Although the order specifically provides that the Commission is going "to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged" and will take further action if it finds "that this approach is inimical to the interests of consumers" (Pet. App. D, p. 40a), the Commission did indicate that if future review showed that small producer rates are too high it would not order refunds of the amounts collected earlier in excess of what it found to be the just and reasonable rate (id. at 37a). The small producer, who generally is not debt financed and must rely on flowing gas sales to generate necessary capital for exploration, should not be subject to refund because otherwise he would necessarily withold some revenue from his drilling activity in order to insure that he can meet any future refund requirements

(App. 84).[15/] Exempting the small producer from the refund requirement in the circumstances here is well within the scope of the Commission's authority under section 4(e) of the Act.

Section 4(e) provides that "the Commission may require the natural gas company * * * to refund any amounts ordered by the Commission, and is empowered "to order such natural gas company to refund, with interest, the portion of such increased rates" which it concludes is not justified. In Placid Oil Co. v. Federal Power Commission, supra, the Fifth Circuit affirmed the Commission's reduction in refund obligations for the Southern Louisiana Area from $375 million to $150 million. The court also approved a procedure that allowed those producers owing refunds to cancel their refund obligation by committing new gas to interstate commerce. It held that the refund provision of Section 4(e) was permissive, not mandatory and afforded the Commission the necessary latitude to achieve the overriding public interest -- an adequate supply of gas at a reasonable price. Chief Judge Brown explains the Court's reasoning as follows (483 F.2d

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15/ The amount of revenue withheld from drilling activity will, of course, increase when the potential refund obligations of the small producers increase and when there is great uncertainty about whether those obligations may be increased. This uncertainty is particularly great where the Commission's area rate, the only approved rate, has been overturned, as is the situation in the Texas Gulf Coast Area. See Texas Gulf Coast Area Rate Cases, D. C. Cir., No. 71-1828, decided Aug. 24, 1973.

at 905):

> * * * Federal Power Commission does not <u>have</u> to order refunds under the terms of the Natural Gas Act. It <u>may</u> do so. And to the extent that it does order refunds, it is empowered to adopt a schedule or structure of refunds which it, in its administrative discretion and expertise, believes will fairly balance the interests of both consumers and producers while achieving the overriding public interest, that interest in the 1970's being the quest for an increased supply to meet an insatiable demand. [Footnotes omitted.]

As we view this case, however, the Commission in declaring that it would not order retroactive refunds by small producers was merely stating what the Act otherwise provides. For the prices that the small producers will receive under Order No. 428, by reason of the structure which the Commission has established, will be just and reasonable. There is no obligation to refund with respect to such rates. Refunds will become an appropriate concern only if the Commission, in its continuing review of the action taken by it here, decides that rates should be fixed some other way for subsequent production.

## CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed and the orders of the Federal Power Commission should be sustained.

Respectfully submitted,

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## PROOF OF SERVICE

The undersigned, a member of the Bar of this Court, hereby certifies that a copy of the foregoing Brief has this the 21st day of November, 1973 been served upon each counsel of record for respondents in accordance with Rule 33 of this Court, by depositing the same in a United States mail box, with first class postage prepaid, addressed to said counsel at their post office addresses.

Ben F. Vaughan

Ben F. Vaughan, III

In The

# Supreme Court of the United States



October Term, 1973

No. 72-1490

Federal Power Commission,
*Petitioner*,

v.

Texaco Inc., et al.,
*Respondents*.

No. 72-1491

Dudley T. Dougherty, et al., Co-Executors of the Estate of Mrs. James R. Dougherty, et al.,
*Petitioners*,

v.

Texaco Inc., et al.,
*Respondents*.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

## BRIEF OF THE SMALL PRODUCERS GROUP AS AMICUS CURIAE

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

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No. 72-1490

FEDERAL POWER COMMISSION,

*Petitioner,*

v.

TEXACO INC., ET AL.,

*Respondents.*

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No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL.,

*Petitioners,*

v.

TEXACO INC., ET AL.,

*Respondents.*

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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## MOTION OF THE SMALL PRODUCERS GROUP FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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The Small Producers Group, which is composed of a number of independent producers of natural gas holding Small-Producer Certificates of Public Convenience and Necessity and thus regulated pursuant to the terms of the Federal Power Commission's Order No. 428, respectfully moves under Paragraph 3 of Rule 42 of this Court for leave to file a brief as *amicus curiae* in support of the position of petitioners in this cause. The Group has been unable to obtain the consent of all the parties to this cause because it lacked adequate time to contact the many parties

to the litigation after the decision to prepare and file a brief was reached.

The Solicitor General indicated in the Government's petition to this Court for a writ of certiorari in the instant case that he considered the principal question of statutory interpretation before the Court to be that of the Commission's authority under Section 16 of the Natural Gas Act, 15 U.S.C. § 717o. We take a somewhat different view of the case. We believe this case raises the question of the scope of the Federal Power Commission's discretion to adopt varying methods of regulation under the Natural Gas Act, and can only be resolved by looking to the fundamental purposes of the Act as a whole. The decision could touch on a host of other cases arising from administrative actions the Commission has taken to construct a workable system of regulation in the midst of a natural gas shortage. Thus every gas producer and every gas consumer in the nation could be affected by the Court's decision in this case. In a case of such significance, the Group believes it appropriate that it be allowed to state an independent position.

WHEREFORE the Small Producers Association prays that this motion be granted.

Respectfully submitted,

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## Brief of the Small Producers Group as Amicus Curiae

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

---

## BRIEF OF THE SMALL PRODUCERS GROUP AS AMICUS CURIAE

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### OPINIONS BELOW AND JURISDICTION

Amicus adopts petitioner's statements of the opinions below and jurisdiction.

## QUESTION PRESENTED

As one step in its efforts to deal with the critical natural gas shortage facing the nation, the Federal Power Commission has attempted to stimulate exploratory drilling by small producers, who have historically drilled 80 percent of all new wildcat wells, by regulating interstate sales of natural gas by small producers in a manner different from the area rate method used to regulate interstate gas sales by large producers. The question presented by the petitions is:

> Whether the Natural Gas Act permits the Federal Power Commission to prescribe a system of regulation for small producers of natural gas that differs from that applied to large producers.

## STATEMENT OF THE CASE

Amicus adopts petitioner's statement of the case.

## INTEREST OF AMICUS CURIAE

To regulate small producers by use of the same system of regulation as is applied to large producers will cause substantial harm to the economic interests of each member of the Amicus association, and by depressing the supply of natural gas, will adversely affect the national economy. Following this Court's decision in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672 (1954), small independent producers, who number in the thousands, were subjected to the same thoroughgoing certificate and rate regulatory methods as major producers. Hence if a small producer drilled (or as is often the case, had a small interest in) a successful gas well, and wished to sell to an FPC-regulated pipeline, he had to retain counsel, file a certificate application with the Commission and wait, frequently for many months, before he could commence selling gas and receiving revenue.

To collect contractually authorized periodic price increases, he had to make a rate increase filing under Section 4(e) of the Natural Gas Act. Even though the annual increase might only be a few hundred dollars, he generally would be forbidden to collect it for six months (thirty days' notice plus a five-month suspension period) and then only subject to refund down to some "just and reasonable" price to be determined subsequently. In many cases, the subsequent determination was not made for years; some of them have not been made yet. The increase received by the small producer could not be plowed back into wildcat drilling because the small producer and his investor partners did not know whether they would have to make refunds. Finally, the maze of certificate, rate increase, refund, in-line, guideline, area rate and other producer litigation that spread through the 1960's was unfathomable to the small producer, who lacked the staff or financial wherewithal to participate in the protracted proceedings before the Commision. But the consequences to the small producer of such litigation were the same to him as to major companies having dozens of lawyers assigned full-time to keeping up with such developments.

Capital formation for small producer wildcat drilling ventures is difficult at best. Banks rarely loan money for this purpose since the risk of non-success is high. Private investors, many of whom are not oil men, are a primary source of capital. To a small producer trying to put a drilling deal together and his potential investors, the regulatory hassle facing him in Washington, if he were lucky enough to discover gas, was viewed as nothing short of nightmarish. If he found gas, the temptation was enormous to dispose of it to a non-jurisdictional intrastate buyer. Many small producers came to the conclusion that it wasn't worth the effort and, as statistics confirm, went into other businesses.

In 1960 there were 18,000 active small producers, but their number had dwindled to 4,000 by 1971. Interstate reserve dedications declined precipitously and, as the Commission found, the public interest was ill-served by the decimation of the small producer ranks.

Yet expanded drilling activity by small producers is of vital public importance. Although small producers are responsible for only 10 per cent of the gas in pipelines, Pet. App. 32a, the Commission found in its rulemaking proceeding that the exploratory efforts of small producers are vital to expanded gas production, Pet. App. 31a, and the Court of Appeals agreed that small producers "have historically accounted for as much as 80 per cent of new exploration, but have less ready access to the necessary capital than do large producers . . . ." Pet. App. 6a. The Commission also found that previous efforts at relief have been inadequate, particularly when small producers have had to seek the same regulatory treatment as large producers. *Exemption of Small Producers From Regulation, Notice of Proposed Rulemaking,* FPC Dkt. No. R-393, 35 Fed. Reg. 12220 (1970). The Commission found, and the Court of Appeals agreed, that the quantum of regulation that small producers have undergone has discouraged their exploration activity and that their realization of full contract prices for sales of gas would assure them of stable revenue sources which could be used in expanding exploration activity. In the Order under review, the Commission conceived its basic consumer protection function under the Natural Gas Act to be twofold: to encourage development and commitment of gas supplies and to protect the consumer against unreasonable prices. Believing that the public is poorly served by technically correct, lengthily adjudicated prices for non-existent gas, the Commission, within the ambit of its discretion, lawfully fashioned a

different regulatory framework for small producers that is consistent with its twofold objective.

## SUMMARY OF ARGUMENT

The issued presented in this case is whether the Commission has the power under the Natural Gas Act to create a simplified regulatory system for interstate sales of gas by small producers that relies on monitoring of contract prices that interstate pipelines agree to pay small producers. The statute does not prohibit a method of regulation such as the one the Commission adopted, and the decisions of this Court have made it plain that the Commission can adopt any method or variety of methods to regulate gas producers that fits the purposes of the Act and produces satisfactory end results. The extensive system of price monitoring the Commission has adopted will serve those purposes by guarding against excessive prices while at the same time eliciting a greater supply of natural gas. For these reasons, the Court below erred in substituting its judgment for the Commission's. The Order under attack should be sustained by this Court as a valid exercise of the Commission's discretion, and the Court should reaffirm the Commission's flexible power to regulate interstate sales of natural gas by producers.

## ARGUMENT

**(1) Section 4(a) of the Natural Gas Act should not be construed to forbid the Commission to adopt indirect price supervision of small producers.**

The fundamental issue before the Court is whether Congress has given the Commission the discretion to create a method of regulation for small producers that differs from that for large producers.

The Natural Gas Act commands only that the prices producers charge "shall be just and reasonable". § 4(a), 15 U.S.C. § 717c(a), Pet. App. G at 85a. It does not provide, by its terms, that the Commission must subject all producers' prices to direct and detailed government regulation to produce rates that are just and reasonable,[1] as the Court of Appeals has erroneously held. *Texaco Inc.* v. *FPC*, — F.2d — (D.C. Cir. No. 71-1560, Dec. 12, 1972), Pet. App. 3a-22a.

The statute does not in terms fix any method of regulation and this Court has never held that the statute requires any particular method—by ceiling prices, cost-of-service calculation, or other schemes—to ensure just and reasonable prices. *Permian Basin Area Rate Cases*, 390 U.S. 747, 776-77 (1968). Nor does the case of *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), necessarily impose on the Commission more than a duty to ensure that rates are just and reasonable, rather than a duty of direct utility-type regulation of price.[2] Nor does the *Catco* case, *Atlantic Refining Company* v. *Public Service Commission of New York*, 360 U.S. 378 (1959), insist on any method of regulation; it

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[1] The Commission did, in fact, impose direct regulation on several aspects of small-producers' prices. *See* page 15 *infra*.

[2] The Court alluded to the Commission's power over prices in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), but it did not purport to define how the regulation was to be implemented. It said:

> The Power Commission is *authorized* by § 4 of the Natural Gas Act to regulate the "rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission . . ." *Id.* at 676 (emphasis added).

The Court went on to say that the producers' "sales in interstate commerce of natural gas for resale are *subject to* the jurisdiction of and regulation by the Federal Power Commission." *Id.* at 676 (emphasis added).

only holds that the Commission has the duty to ensure that initial gas rates are in "the public interest." *Id.* at 392.

The Court of Appeals for the Fifth Circuit has interpreted the Natural Gas Act to allow action like that the Commission took in Order No. 428. In the *Southern Louisiana Area Rate Cases,* the Fifth Circuit said:

> The decisions of the Supreme Court definitely indicate that the Commission has a responsibility to take the steps necessary to assure that wellhead prices are in the public interest. The Commission does not have to employ the area rate method, or for that matter regulate price directly at all, but it has chosen to fulfil its duty in that manner here.

*Austral Oil Co.* v. *FPC,* 428 F.2d 407, 415 n.9 (5th Cir.), *cert. denied,* 400 U.S. 950 (1970)

The Fifth Circuit has correctly construed the Act,[3] because this Court, in examining the purposes of the Natural Gas Act, has held that the statute's language must be interpreted to allow the Commission the utmost flexibility and discretion in fashioning effective methods of producer regulation.

> This Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred . . . . Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.

*Permian Basin Area Rate Cases,* 390 U.S. at 776.

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[3] This interpretation of the Act is supported in Breyer & MacAvoy, *The Natural Gas Shortage and the Regulation of Natural Gas Producers,* 86 HARV. L. REV. 941, 986-87 (1973) [hereinafter cited as *Breyer & MacAvoy*]. These authorities conclude that "[n]othing in the *Phillips Petroleum* decision *requires* the FPC to set prices . . . ," and thus that the FPC has the power to practice "selective rather than pervasive interference with field market transactions." *Id.*

The principal purpose of the Natural Gas Act was to ensure that consumers receive the supplies of natural gas they need at reasonable prices, by "balanc[ing] . . . the investor and the consumer interests." *Id.* In this balancing process, price is a neutral element. The specific evil Congress sought to remedy in enacting the legislation was *excessive* prices charged by gas companies with monoply power to raise prices at will. Thus the immediate purpose of the statute was "[p]rotection of consumers against exploitation at the hands of natural-gas companies . . . ." *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672, 685 (1954). It follows that the Commission has the power under the statute to adjust the method and intensity of its regulation to the power of natural-gas companies to exploit consumers. Here the Commission has determined that small producers lack the power to exploit consumers,[4] and it has decided on an experimental program of indirect price regulation to create for small producers the incentive to expand their efforts in exploration and development by freeing them of many of the administrative and price aspects of regulation that have choked off their production under the area rate ceilings.[5]

The Court below held that small-producers' prices could not be exempted from the regulatory scheme, which it took to be the area rates the Commission has found to be "just and reasonable," because regulation that failed to set price levels would be "outside the present language of the Act." Pet. App. 17a. But the test of whether a price is just and reasonable is not whether it conforms to the area-rate method of price-setting, or whether a Government agency sets it all, but whether it produces results that are in accord with the purposes of the Act. *Compare Atlantic Refining Company*

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[4] *See* page 19 *infra.*
[5] *See Breyer & MacAvoy* at 958-962.

v. *Public Service Commission*, 360 U.S. 378, 390-92 (1959), *with United Gas Pipeline Company* v. *Mobile Gas Service Corporation*, 350 U.S. 332 (1956). There is no magic number that the Commission must uncover before there can be a just and reasonable price. In fact, there is no definition of a just and reasonable price in the Act at all; it is only a price that "is necessary in the public interest." Natural Gas Act, § 1(a), 15 U.S.C. § 717(a).

Thus, as Mr. Justice Jackson wrote in his celebrated concurring opinion in the *Colorado Interstate* case, price is "a tool to bring goods to market—to obtain for the public service the needed amount of gas." *Colorado Interstate Gas Company* v. *FPC*, 324 U.S. 581, 612 (1945) (concurring opinion). The only just and reasonable price is one that produces the needed amount of gas without concomitant exploitation of consumers. It follows that the prices paid to small producers can be wholly different from large-producer prices and set by altogether different standards and remain just and reasonable if they serve the purposes of the statute. This Court has held that the Commission has the power under the just and reasonable standard of the Act to

> employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price for future programs of exploration and production.

*Permian Basin Area Rate Cases*, 390 U.S. at 797.

In the *Permian Basin* case, the Court had before it a Commission order that provided for a two-price system of ceiling rates, based on the date of discovery of the well. The purpose of this system was to provide a higher price as an incentive for the discovery of new gas, while holding the price of old gas already discovered to the levels of average

historical cost. This was attacked as producing an anomalous situation in which two producers, side by side, could receive two different "just and reasonable" prices for gas of identical quality and Btu content. But the Court held that the statute sanctions different prices for different sales.

> We hold that the stautory "just and reasonable" standard permits the Commission to require differences in price for simultaneous sales of gas of identical quality, if it has permissibly found that such differences will effectively serve the regulatory purposes contemplated by Congress.

*Id.* at 797-98.

Thus Order No. 428 is fully consonant with the Court's broad construction of the Act. It offers an incentive to exploration but guards against excess prices. Price is being used here for exactly the same purpose as the two-price system was used in the *Permian Basin* case, and the Court has made clear that it is not how the price is arrived at but what it results in that determines whether it squares with the statute.

**(2) The Federal Power Commission has been granted broad discretion and flexibility to fashion effective methods of regulation under the Natural Gas Act; and the Court of Appeals erred in substituting its judgment for the Commission's.**

The Commission has been held to have a "legislative discretion" in the process of regulating natural gas prices that embraces "the method used in reaching the legislative determination as well as the determination itself." *Permian Basin Area Rate Cases*, 390 U.S. at 776; *Los Angeles County Gas Company* v. *Railroad Commission*, 289 U.S. 287, 304 (1933). When the Commission determines that effective regulation requires the adoption of new methods,

this Court should not set aside that determination unless it bears no rational relationship to the just and reasonable standard of the Act.

This Court has held that the determination at issue here is of the type that has been entrusted to the expert judgment of the Commission, so long as the end result accords with the statute:

> [W]e have heretofore emphasized that Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not to the preferences of reviewing courts. A presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *FPC* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602. We are not obliged to examine each detail of the Commission's decision; if the "total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Ibid.*

Moreover, this Court has often acknowledged that the Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within the "zone of reasonableness." *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 585. No other rule would be consonant with the broad responsibilities given to the Commission by Congress; it must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests. It is on these premises that we proceed to assess the Commission's orders.

*Permian Basin Area Rate Cases,* 390 U.S. at 767.

The history of regulation under the statute shows that this Court has consistently interpreted the Natural Gas Act as laying down no formula and prescribing no method for the supervision of natural gas prices. This Court has recognized that the Commission must make "pragmatic adjustments," *FPC* v. *Hope Natural Gas Company,* 320 U.S. 591, 602 (1944), and that it must not be bound to "any artificial rule or formula." *Los Angeles Gas Company* v. *Railroad Commission,* 289 U.S. at 305. This broad discretion is to allow the Commission to adapt to changed circumstances with new methods consistent with the purposes of the regulatory power. *Id.*; *see American Trucking Associations* v. *United States,* 344 U.S. 298 (1953); *National Broadcasting Company* v. *United States,* 319 U.S. 190 (1943).

The history of regulation of natural gas producers under this Act demonstrates that the Commission is free to adjust its methods of regulation when they prove ineffective. The Commission began to regulate producers by determining their costs of service, but when it concluded that that method was neither "workable or desirable," the Court allowed it to abandon proceedings in progress that relied on that method and to adopt the area-rate method of ceiling price regulation. *Wisconsin* v. *FPC,* 373 U.S. 294, 299, 314 (1963). The Court, noting the "unique problems" confronting the Commission, *id.* at 296, considered the argument that the cost-of service method was the only lawful method of regulation and said:

> [T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly

> articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method will be followed by the Commission in considering the justness and reasonableness of rates.

*Id.* at 309.

When the actual method of area rates was reviewed by the Court, it approved the Commission's order, at the same time making it clear that it expected many questions to be "more precisely and efficaciously" treated in the future, *Permian Basin Area Rate Cases,* 390 U.S. at 822, and warning the Commission that it needed to take "many steps toward a more expeditious and effective system of regulation," *id.* at 772 n.37. Nevertheless, the Court entrusted the method of regulation to be followed to the Commission's informed judgment. *Id.* at 776-77. Thus the Court has declined to instruct the Commission to follow any particular method for deciding what constitutes just and reasonable prices that the Commission must follow.

In fact, not only has the Court made it clear that it expects the Commission to make its own determinations, the *Permian Basin* case specifically instructs the Commission to continue to re-evaluate its methods in the light of these same "unique problems" it faces and the goal it seeks to reach. This case represents another modification in the evolution of regulation of producers, and the Commission's method of small producer regulation should be upheld as just and reasonable, for the Order in question lies clearly within the Commission's special expertise.

**(3) Order No. 428 constitutes a valid exercise of the Commission's legislative discretion because it will ensure gas production at just and reasonable rates.**

The rulemaking that produced Order No. 428 was initiated after a clear instruction from this Court that the Commission was to heed warnings that area ceilings were likely to cut production by forcing higher-cost producers out of business. The Court said:

> We are cognizant, as presumably is the Commission, of the forceful argument that the computation of rates from costs is ultimately circular . . . We assume that the Commission will continue to examine both the premises of its regulatory methods and the consequences for the industry's future of its rate-making orders. Nothing under the Act or the cases of this Court compels the Commission to reduce its regulatory to self-fulfilling prophecies.

390 U.S. at 816 n.99. *See Breyer & MacAvoy* at 961-62 & n.79.

The Commission's Order was issued on the basis of its expert judgment after a seven-month process of rulemaking that weighed comments from 73 parties. It was begun two years after the Court's instructions to ponder its methods of producer regulation in the *Permian Basin Area Rate Cases, supra.* The Commission gave great weight to indications that small-producer exploration activity, often carried on at higher costs than that of the major producers, was being curtailed because of ceiling-price regulation.[6] Faced with a spreading gas shortage, the Commission believed that action to remedy this situation was imperative, since small producers have accounted for as much as 80

[6] *See Southern Louisiana Area Rate Cases,* 428 F.2d 407, 442 & n.13 (5th Cir.), *cert. denied,* 400 U.S. 950 (1970); *Breyer & MacAvoy* at 961-62. *See* note 11 *infra.*

per cent of new exploration. Pet. App. 31a. Since the small producers account for only about 10 per cent of gas entering pipelines, the Commission believed that it was balancing consumer and producer interests, with consumers being provided important new sources of gas in return for de minimis price increases. Pet. App. 32a.

(a) *The Commission has devised an effective regulatory method for small producers.*

The Commission made it plain in Order No. 428 not only that it retains jurisdiction over small producers but also that it intends to monitor their sales closely to ensure just and reasonable prices.

> The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales. We shall also provide certain other safeguards against unreasonably high small producer prices, as hereinafter discussed, to assure adequate protection for the consumer.

Pet. App. 32a.

The other safeguards the Commission adopted consisted of direct regulation of several aspects of small-producer prices. It proscribed the use of certain contract provisions, above area ceiling prices. These included favored-nations, price - redetermination, and spiral - escalation provisions "that may have an adverse impact on consumers." Pet. App. 32a-33a; *see FPC* v. *Texaco Inc.*, 377 U.S. 33, 41 (1964). The Commission also regulated the sale by large producers to small producers of developed gas reserves by providing that they must have separate authorization. Pet. App. 33a.

The Commission announced it would scrutinize pipeline purchases from small producers by ordering the filing of all

contracts, and order pipeline and large-producer refunds where prices paid by them are "unreasonably high," that is to say, above market prices, which gives pipelines an incentive to bargain with small producers for a lower price. Pet. App. 37a-38a. The Commission noted that the market standard, which is based on comparison with the highest contract prices of intrastate producers or large producers in the area, would likely produce de minimis price increases. "[A]s a practical matter, the small producer is normally not in a position to obtain more for the sale of its gas than the large producer whose jurisdictional sales are subject to the ceilings prescribed by the Commission in each area. The impact on the consumer of exempting small producers from regulation should thus be minimal." "*Exemption of Small Producers From Regulation, Notice of Rulemaking*, FPC Dkt. No. R-393, 35 Fed. Reg. 12220 (1970). But the Commission still exacted a quid pro quo for the price relief thus dispensed. It provided that if a small producer finds new gas reserves and contracts to sell them in the interstate market, he must continue sales of his gas reserve to the interstate buyer until depletion or until abandonment authorization is obtained from the Commission under Section 7(b) of the Act. 15 U.S.C. § 717o(b). The practical effect of this requirement is that the small producer must continue to sell gas until his reserve is exhausted and cannot exceed his contract rate after expiration of the contract unless the Commission grants him permission. Pet. App. 36a n.4.

The Commission retains its statutory power of intervention in any gas-sales contract it finds, as a result of this monitoring, to be unjust or unreasonable. This power of intervention, in Section 5(a) of the statute, will allow the Commission to "order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise un-

lawful, or are not the lowest reasonable rates." § 5(a), 15 U.S.C. § 717d(a).

The Commission has thus erected an extensive system of market supervision and control for small producers, which includes price monitoring, proscription of certain practices as unjust and unreasonable, sanctions against pipelines to ensure hard bargaining, and the prospect of price roll-backs wherever the Commission finds that undue or excessive market power exists on the part of a producer. A number of experts have urged the use of methods like these to correct the failures of past methods of regulation;[7] even the Court of Appeals agreed that the Commission "appears to have made a powerful case." Pet. App. 18a. But the majority of the Court of Appeals nonetheless characterized the system as "non-regulation." Pet. App. 16a. The better view is expressed in the dissenting opinion of Judge Fahy:

> [T]he question is whether we can hold, on the record before us, that the type of regulation of prices adopted by the Commission has led or will lead inevitably to unjust or unreasonable rates charged by small producers to purchasers of gas from them . . . .
> . . . A higher rate than that previously fixed for the industry in the area may be just and reasonable for the small producer as a separate classification within the area. The Commission is attempting to learn whether under this program the small producers, relieved of much of the burden of regulation required of other

[7] C. HAWKINS, THE FIELD PRICE REGULATION OF NATURAL GAS 211-16 (1969); *see Breyer & MacAvoy* at 948, 985-86; Testimony of M. Adelman, *Hearings Pursuant to S. Res. 45 Before the Senate Comm. on Interior & Insular Affairs*, 92d Cong., 2d Sess. 54-55 (1972); Brown, *Introduction* to REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 12 (1970); Russell, *Producer Regulation for the 1970s* in *id.* 234.

classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable, and which will not adversely affect the consumer interests protected by the Act.

Pet. App. 19a-20a.

As Judge Fahy observes, no rates have been attacked as unjust or unreasonable under this Order. Pet. App. 21a. In fact, all three judges on the Court agreed that the Commission's experimental system for the regulation of small producers represents wise policy, and constitutes an exercise of the Commission's "diligence and expertise," Pet. App. 17a, to which this Court has always afforded decisive weight. *Permian Basin Area Rate Cases*, 390 U.S. at 767. Plainly the Commission's determinations, shaped by its regulatory experience and its expertise, constitute a complete system of regulation. Far from "abdicat[ing] its regulatory responsibility," Pet. App. 12a-13a, the Commission has fulfilled it with a carefully drawn and thoroughly considered plan for the price supervision of small producers.

(b) *The characteristics of the small producer segment of the producing industry permit effective regulation in this manner.*

The purpose of the Act is to balance the interests of consumer and producer while at the same time protecting the consumer against exploitation at the hands of natural-gas companies. Since it is axiomatic that small producers generally lack the monopoly power to charge consumers excessive prices for supplies of natural gas, ceiling-price regulation is not only unnecessary for them but harmful to the consumer's own best interest by depressing supply.[8] Here the Commission has based its judgment on its long

[8] *See Breyer & MacAvoy* at 948-49.

experience with natural gas producers. There are thousands of small producers of gas, and entry into the business is free.[9] In removing direct price ceilings for small producers, the Commission determined in Order No. 428 that there is little risk that they will charge the consumer excessive prices. "Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce." Pet. App. 31a. The Commission was acting against a background of ample evidence that attempts to regulate the naturally competitive segments of the natural gas producing industry with ceiling prices[10] have brought

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[9] The Commission has pointed out that there were more than 18,000 producers in 1960, but the number had fallen to 4,000 by 1971. *Belco Petroleum Corp.*, ___ F.P.C. ___, slip. op. 12-13 (May 30, 1973). *See also Permian Basin Area Rate Cases*, 390 U.S. at 784 n.49. Of these 4,000, about 85 are large producers selling more than 10 million Mcf of gas per year. *Order Establishing Hearing to Show Cause Why Uncommitted Gas Reserve Data Should Not be Produced in Nationwide Investigation*, FPC Dkt. No. R-405-A, 38 Fed. Reg. 29821, 29822 n.2 (Oct. 29, 1973).

One economist has found that after the largest producers are accounted for, the rest of the market is "relatively unconcentrated" and that "the barriers to entry for natural gas production are substantially less than in most manufacturing." Hawkins, *Structure of the Natural Gas Producing Industry* in REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 137, 141, 138 (1970).

[10] Indeed, the goal of regulation is to set monopoly prices at the same level as competitive prices. "The object of regulation is to achieve the results that free market competition produces in other industries . . ." J. McKIE, THE REGULATION OF NATURAL GAS 5 (1957).

on the gas shortage.[11] The effect of the Commission's determination in this situation is to improve the effectiveness of regulation by adopting the pricing method most likely to produce quickened gas exploration.

The Court of Appeals rejected this exercise of the Commission's informed judgment as "semantic." Pet. App. 14a. The majority said the Commission "ignores the essential difference between a regulated and an unregulated industry. Put simply, the latter is governed by the market while the former, by definition, is the subject of active governmental control". *Id.* But this Court has found that natural gas producers do not constitute a typical regulated industry because they do not possess the natural monopoly characteristic of virtually all other regulated industries. "[P]roducers of natural gas cannot usefully be classified as public utilities." *Permian Basin Area Cases,* 390 U.S. at 756; *see id.* n.11, 757.

Thus the Court of Appeals, spurning the Commission's expert judgment and failing to examine its premises, struck the order because it was evident that small producers' rates were to be exempt from "previously Commission-determined 'just and reasonable' rates." Pet. App. 14a. In so doing, the Court erred.

(c) *This method of regulation assures the consumer that he will benefit by obtaining additional supplies of natural gas at just and reasonable prices.*

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[11] *Breyer & MacAvoy* at 976-79; MacAvoy, *Regulation-Induced Shortage of Natural Gas,* 14 J. LAW & ECON. 167, 168 (1971); *see* Brown, *Introduction,* REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 7, 11 (1970); Erickson & Spann, *Price, Regulation, and the Supply of Natural Gas in the United States, id.* at 214; Russell, *Producer Regulation for the 1970s, id.* at 228-29; *cf.* Kitch, *Regulation of the Field Market for Natural Gas by the Federal Power Commission,* 11 J. LAW & ECON. 243, 277-79 (1968).

Low prices alone are not the *sine qua non* of producer regulation, for price is not an end in itself but only a mechanism by which supply is brought forth. The United States contains between 1,178 and 2,100 trillion cubic feet of undeveloped natural gas. FPC BUREAU OF NATURAL GAS, NATURAL GAS SUPPLY AND DEMAND, 1971-1990, *Staff Report No.* 2, at 13 (FPC Pub. No. S-218, 1972). Yet current proved reserves fell by 10 per cent in the late 1960's and continue to drop now. The gas shortage has caused large numbers of consumers to be denied gas service at all, and has seriously affected economic growth. *Breyer & MacAvoy* at 980-84. The Commission itself has described the gas shortage as "devastating." *George Mitchel & Associates,* F.P.C. Op. No. 649, — F.P.C. — slip op. at 6 (Feb. 21, 1973). From 1971 to 1972, seven major pipelines were forced to curtail winter service, and the FPC staff, which has found deliveries fell short of consumption by 5.1 per cent in the winter of 1972, predicts they will fall short by 12.1 per cent in 1975. MacAvoy & Pindyck, *Alternative Regulatory Policies for Dealing with the Natural Gas Shortage,* BELL J. ECON. & MANAGEMENT SCIENCE 454, 455 (Autumn, 1973). For the year April 1972 to March 1973, curtailments of gas supplied by interstate pipelines was estimated to have reached one billion cubic feet. *Just and Reasonable National Rates for Future Sales of Natural Gas from Wells Commenced on or After January 1, 1973, Notice of Rulemaking,* FPC Dkt. No. R-389B — Fed. Reg. — (April 11, 1973). The FPC has estimated that the annual level of unsatisfied demand will increase from 3.6 trillion cubic feet in 1975 to 9.5 trillion cubic feet by 1980, with a further increase to 17.1 trillion cubic feet by 1990. FPC BUREAU OF NATURAL GAS, NATIONAL GAS SUPPLY AND DEMAND, *supra,* at 3.

To help ameliorate the shortage, the United States has been forced to import alternate fuels in the form of lique-

fied natural gas and higher priced Canadian supplies and to lay plans to produce gas from coal and naptha. Since all these expedients can be purchased only at prices double or triple the ceiling price of natural gas in the United States,[12] the domestic consumer will benefit directly by the expanded domestic supply that indirect regulation of small producers will bring.

The Commission has recognized that the consumers' real interest now coincides with that of the small producer. Thus the Commission has promulgated the Order based on its expert judgment that removal of "unwise and self-defeating limits" for small producers will help expand the natural gas supply at just and reasonable prices. The Commission has concluded that under the Natural Gas Act, that which is "economically wise" must be "legally permissible." *FPC v. Hope Natural Gas Company,* 320 U.S. 591, 652 (1944) (dissenting opinion). The Order should be sustained because it falls within the Commission's statutory power and its administrative discretion.

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[12] Foster, *Projected Costs of Alternate Sources of Gas,* REGULATION OF THE NATURAL GAS PRODUCING INDUSTRY 63, 88 (1970); *Belco Petroleum Corporation, supra,* note 10, at 36-37.

## CONCLUSION

The Small Producers Group urges the Court to reverse the Court of Appeals and affirm Order No. 428 of the Federal Power Commission.

Respectfully submitted,
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IN THE

# Supreme Court of the United States

SPRING TERM, 1974

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No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner,*

v.

TEXACO, INC., *Respondent*

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No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO.
EXECUTORS OF THE ESTATE OF MRS. JAMES R.
DOUGHERTY, ET AL., *Petitioner,*

v.

TEXACO, INC., ET AL., *Respondent.*

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**On Writ of Certiorari to the United States Court of Appeals for the District of Columbia**

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## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE ON BEHALF OF THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

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### INTEREST OF AMICUS CURIAE

The Independent Petroleum Association of America (IPAA) would respectfully show the following to demonstrate its interest in this case:

I.

The Independent Petroleum Association of America (IPAA) is a non-profit organization, incorporated

under the laws of the State of Oklahoma and is a national trade association representing approximately 4,000 independent oil and natural gas producers in every producing region of the United States. A large portion of its membership which produce natural gas falls within the "small producer exemption."[1]

## II.

IPAA and its members have a substantial interest in the matters under consideration in the above-captioned cases. The determination of the issues presented herein could very materially affect the substantive rights of the membership of IPAA.

## III.

IPAA took an active part in the Permian Basin Area Rate case, 34 FPC 159 (1965) the Initial Natural Gas Area Rate Proceeding, on behalf of its membership. However, as an Association, it did not have available individual company costs and other material which were required in this proceeding. IPAA cooperated with the Staff of the Federal Power Commission in an attempt to obtain meaningful information from the small producers segment of the industry.

The Commission recognized early in this initial area rate proceeding covering the Permian Basin that the methodology being pursued therein with respect to and based upon over-all industry questionnaires, etc., could not realistically apply to small producers of natural gas for various reasons. Thus the Commission set

[1] "Small producers" are defined by the Federal Power Commission as those whose jurisdictional sales of natural gas do not exceed 10,000,000 Mcf annually.

about to exempt them from the questionnaire and other requirements being made of the larger producers.

In due course, the Commission concluded (34 FPC at pages 234-5) that it was in the public interest to accord special treatment to small producers which would ease the burdens of regulations without the risk of substantial impact on consumer prices.

Accordingly, in establishing just and reasonable rates for all producers in the Permian Basin Area, the Commission issued Order 308 on October 29, 1965, 34 FPC, 1202, which relieved small producers from almost all of the administrative burdens and expenses concerning the rate and certificate provisions of the Natural Gas Act. The small producer certificates were authorized for any producer with jurisdictional sales of less than 10,000,000 Mcf per year subject to contract rates not in excess of the established ceilings in the pertinent area. The Supreme Court affirmed this action by the Commission in the Permian Basin Cases, 390 U.S. 747, 787 (1968).

Subsequently, on July 23, 1970, the Federal Power Commission issued a Notice of Proposed Rulemaking, Docket No. R-393, "proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers, i.e. jurisdictional sales which do not exceed 10,000,000 Mcf in a calendar year."

IPAA filed with the Commission its comments in support of this proposed Rulemaking and also took an active role in support thereof at an informal conference held on December 8, 1970, between the Commission Staff and interested parties.

In addition, the IPAA, participated as an Amicus Curiae in the proceeding below.

These cases are before this court by reason of the Petitioners hereto contending, in general, that Federal Power Commission Order No. 428, which exempts small producers of natural gas from direct FPC regulation, is lawful under the Natural Gas Act.

IPAA supports the action of the Federal Power Commission in issuing Order No. 428, issued March 18, 1971, and Order No. 428-B entitled "Order Modifying Order No. 428 and Denying Applications For Rehearing," issued July 15, 1971.

IPAA submits that these orders are vital to small producers of natural gas, and are in the public interest.

Further, IPAA submits that these orders are *legal* and are based on adequate findings pursuant to the notice of proposed rulemaking issued by the Federal Power Commission in accordance with all procedural requirements as prescribed in Section 553, Title 5, of the United States Code.

Wherefore, for the foregoing reasons, IPAA respectfully moves for leave to file a Brief Amicus Curiae in these cases, and for all other proper relief in the premises.

Respectfully submitted,

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

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Dated at Washington D.C.
November 23, 1973

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CITATIONS

# In the Supreme Court of the United States

OCTOBER TERM, 1973

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No. 72-1490

FEDERAL POWER COMMISSION, PETITIONER

*v.*

TEXACO, INC., ET AL.

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT*

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**BRIEF FOR THE FEDERAL POWER COMMISSION**

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**OPINIONS BELOW**

The opinion of the court of appeals (Pet. App. 1a-22a) is reported at 474 F. 2d 416. The initial order (No. 428) of the Federal Power Commission (App. 135-154), its order (No. 428-A) of amendment (App. 159-161), and its order (No. 428-B) denying rehearing (App. 238-253) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

**JURISDICTION**

The judgment of the court of appeals (Pet. App. 23a-25a) was entered on December 12, 1972, and the Commission's petition for rehearing was denied on

February 5, 1973 (Pet. App. 26a–28a). The petition for a writ of certiorari was filed on May 3, 1973, and was granted on October 9, 1973 (App. 254).[1] The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTION PRESENTED

Whether the Federal Power Commission has authority to exempt small producers from certain filing requirements under the Natural Gas Act, as amended, 15 U.S.C. 717, *et seq.*, and to regulate the interstate wholesale sales of such small producers indirectly by determining, in pipeline rate proceedings, whether the pipelines' costs of purchasing gas from small producers are reasonable.

## STATUTES INVOLVED

Sections 4, 5, 7, and 16 of the Natural Gas Act, 15 U.S.C. 717c, 717d, 717f, and 717*o*, are set forth in the Appendix to this brief, *infra*, pp. 35–43.

## STATEMENT

### A. BACKGROUND

In 1954, this Court held in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, that the Federal Power Commission has jurisdiction under the Natural Gas Act, as amended, 15 U.S.C. 717, *et seq.*, to regulate well-

[1] The Court concurrently granted the petition in No. 72-1491—which sought review of the same judgment of the court of appeals—and ordered the cases consolidated for oral argument (App. 254).

head sales by producers of natural gas to interstate pipelines. Producers were thus required under section 7(c) of the Act, 15 U.S.C. 717f(c), to obtain certificates of public convenience and necessity to cover their sales to interstate pipelines; all contracts covering such sales were required to be filed with the Commission under Section 4(d) of the Act, 15 U.S.C. 717c(d), and all rates and charges were required under Section 4(a), 15 U.S.C. 717c(a), to be "just and reasonable." Under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d, the Commission is empowered to inquire into the lawfulness of any rate and, in the event it finds a rate unlawful, to determine and prescribe the just and reasonable rate.

Following the *Phillips* decision, the Commission at first attempted to regulate producer sales on a traditional, individual basis. After this method of regulation proved thoroughly impractical, the Commission in 1960 instituted area rate proceedings to determine maximum producer rates for each of the major producing areas. See *Permian Basin Area Rate Cases,* 390 U.S. 747, 755–758. The area rate proceedings themselves have proved to be enormously complex, and the Commission has accordingly found its ability to meet its obligations under the Act to regulate producer sales to be critically dependent upon its authority under Section 16, 15 U.S.C. 717*o*, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

Indeed, this Court has encouraged the Commission to make liberal use of this statutory authority to treat different classes of producers differently. The suggestion that small producers be exempted from certain provisions of the Act was first made by Mr. Justice Clark in dissent (*Wisconsin* v. *Federal Power Commission,* 373 U.S. 294, 329-330) and was later reiterated by him speaking for a majority of the Court (*Federal Power Commission* v. *Hunt,* 376 U.S. 515, 527). The Commission followed these suggestions in its first area rate proceeding and exempted small producers from various filing requirements under Sections 4 and 7 of the Act (34 FPC 234, 235). On review, this Court sustained the Commission's separate treatment of small producers; it held (*Permian Basin Area Rate Cases, supra,* 390 U.S. at 787):

> We conclude that these arrangements did not exceed the Commission's statutory authority. We recognize that the language of §§ 5 and 7 is without exception or qualification, but it must also be noted that the Commission is empowered, for purposes of its rules and regulations, to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." § 16, 15 U.S.C. § 717*o*. The problems and public functions of the small producers differ sufficiently to permit their separate classification, and *the exemptions created by the Commission for them are fully consistent with the terms and purposes of its statutory responsibilities.* It is not without relevance that this Court has previously expressed the belief that

> similar arrangements would ameliorate the Commission's administrative difficulties. See *F.P.C.* v. *Hunt,* 376 U.S. 515, 527. [Emphasis supplied.]

In recent years, the Commission's difficulties in regulating producer sales have been compounded by the increasingly critical shortage of natural gas supplies. This shortage, which has been judicially recognized by this Court and the courts of appeals,[2] has seriously affected the ability of the Nation's major pipelines to meet the demands of their interstate markets. At the current time, 26 curtailment proceedings—of the type before this Court in *Federal Power Commission* v. *Louisiana Power & Light Co.,* 406 U.S. 621—have been initiated before the Commission. It is in this context that the Commission's special treatment of small producers in the instant controversy should be viewed.

### B. PROCEEDINGS BEFORE THE COMMISSION

In July 1970, the Commission initiated the present proceedings by issuing a notice of proposed rulemaking proposing to exempt from regulation under the Natural Gas Act all existing and future jurisdictional sales made by small producers[3] (35 Fed. Reg.

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[2] See, *e.g., Federal Power Commission* v. *Louisiana Power & Light Co.,* 406 U.S. 621, 626; *Placid Oil Co.* v. *Federal Power Commission,* 483 F. 2d 880, 894–897 (C.A. 5); *Public Service Commission for the State of New York* v. *Federal Power Commission,* 467 F. 2d 361 (C.A. D.C.).

[3] Small producers are defined as those with jurisdictional sales of less than 10,000,000 Mcf (thousand cubic feet) of gas per year.

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12220). Following the receipt of comments from numerous parties (see App. 14–96) and an informal conference among the Commission's staff and interested persons (App. 97–134), the Commission issued Order No. 428 (App. 135–154). In that order, the Commission did not exempt small producer sales from all regulation, but rather adopted a form of regulation which it deemed appropriate in the circumstances.

The purpose and intended effect of the Commission's action were stated in Order No. 428 as follows (App. 137):

> One of the important Commission responsibilities under the Natural Gas Act is to assure maintenance of an adequate gas supply for the interstate market. By our action herein, we are taking an important step forward to meet this responsibility. Upon review of the contentions made by the various parties, we have decided that both existing and future sales of small producers shall be regulated in the manner hereinafter provided.
>
> Such action should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas. Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the

> expenses and burdens relating to regulatory matters. Our action should also ease the administrative burdens connected with processing small producer filings.[4]

The action taken by the Commission was to establish a procedure whereby each small producer could obtain a blanket certificate to cover all existing and future sales. Once the blanket certificate was obtained, the small producer would be authorized to sell natural gas at negotiated contract prices whether or not such prices are in excess of the area rates established by the Commission;[5] the small producers were relieved of all filing requirements under the Natural Gas Act or the Commission's regulations other than the requirement to file annual reports (App. 143–144).

The Commission expressly stated that its action does not constitute "deregulation" of small producer sales (App. 138). Such sales would be regulated indirectly through review of purchased gas costs in pipeline rate proceedings (*ibid.*). Pipeline rates would be subject to reduction and refund to the extent that they were based upon small producer rates which were found to be "unreasonably high" in light of "appropriate comparisons with highest contract prices for sales by large

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[4] While the Commission stressed the importance of small producer exploratory efforts, it also noted that actual small producer sales amounted to an average of only 10.52 percent of the needs of interstate pipelines (App. 137).

[5] In Order No. 428-B, modifying Order No. 428 and denying applications for rehearing, the Commission ruled that sales made by small producers under blanket certificates could not be abandoned without Commission authorization pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b) (App. 242–243).

producers or the prevailing market price for intrastate sales in the same producing area" (App. 142). In order to assure the certainty of the capital flow necessary to encourage exploration and development by small producers, however, the Commission exempted small producers from any refund obligations (App. 142–143).

Finally, the Commission expressed its intention

> * * * to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers. [App. 145.]

In April 1971, the Commission issued Order No. 428–A (App. 159–161) prescribing the form of the annual statement to be filed by small producers operating pursuant to blanket certificates. In July 1971, the Commission issued Order No. 428–B (App. 238–253) modifying Order No. 428 in certain respects and denying applications for rehearing.[6]

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[6] The Commission subsequently issued two additional orders slightly modifying the reporting requirements under Order No. 428. Order No. 428–C, issued in April 1972 (37 Fed. Reg. 7591), requires pipelines and large producers to estimate the annual volume of gas they purchase from each small producer. Order No. 428–D, issued in May 1972 (37 Fed. Reg. 9559), revises the form of the annual report to be filed by small producers.

### C. THE DECISION BELOW

On petitions for review, the court of appeals, with one judge dissenting, set aside the Commission's orders establishing a blanket certificate procedure for small producers (Pet. App. 1a–22a). The court concluded that, by authorizing blanket certificates for small producer sales, the Commission had abdicated its statutory responsibilities under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d, to insure that small producer rates will be "just and reasonable" (*id.* at 10a–16a). The court rejected the Commission's contention that small producer sales could appropriately be regulated indirectly by reviewing the reasonableness of purchased gas costs in pipeline rate proceedings, because in its view the Commission's order ties the reasonableness determination to "factors which it does not regulate or which derive solely from market forces" (*id.* at 12a).[7]

Judge Fahy dissented. Citing this Court's recent decision in *Federal Power Commission* v. *Louisiana Power & Light Co.*, 406 U.S. 621, he concluded (*id.* at 19a–20a):

[7] The Commission issued a number of blanket certificates to small producers under Order No. 428 prior to the court's decision. It has subsequently issued "temporary certificates" permitting small producers to collect their contract rates in accordance with Order No. 428 but providing that the amounts collected will be subject to refund with interest if the court of appeals' decision is upheld by this Court.

> The Commission has made a judgment which I think is within the ambit of its competence and expertise not to require small producers to be bound to the area rate and certain filing requirements, on an experimental basis. * * * The Commission is attempting to learn whether under this program the small producers, relieved of much of the burden of regulation required of other classifications, can improve their exploratory efforts while charging rates which on review will nevertheless prove to be just and reasonable, and which will not adversely affect the consumer interests protected by the Act. [Footnotes omitted.]

## SUMMARY OF ARGUMENT

A. Central to the decision below is the court of appeals' view that the Commission, in Order No. 428, has abdicated its responsibility under Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c and 717d, to ensure that small producers' rates are "just and reasonable." That is not, however, the effect of the order. It does not deregulate the sales of small producers; it establishes a new method of regulating such sales. Instead of the traditional review at the producer level, the order provides for indirect review in pipeline rate proceedings, where the Commission will determine whether the pipeline's costs—*i.e.*, the small producer's rates—are unreasonably high.

Contrary to the court of appeals' view, the reasonableness determination will not depend exclusively on field prices. The order does refer to two field price factors that the Commission will take into account, but reasonableness remains the standard and the Com-

mission stated that it would "consider *all* relevant factors" (App. 142; emphasis added).

B. The issue, therefore, is not whether small producers may be exempted from rate regulation but whether it is consistent with the provisions of the Natural Gas Act for their rates to be regulated indirectly at the pipeline level. The Act does not limit the Commission to any particular regulatory method; "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling" (*Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602). Order No. 428 is reasonably designed to stimulate exploration, and thus increase the supply of natural gas, while ensuring that small producer rates remain "just and reasonable." It assures small producers—traditionally responsible for 80 percent of the natural gas exploration—an adequate and stable flow of revenue to support exploratory activity by permitting them to collect their negotiated contract prices without refund obligation; but it does not foreclose prospective reductions of prices found to be unreasonably high. Since pipelines may pass on only that portion of a small producer's rate increase that is not unreasonably high, they have a strong incentive to negotiate for the lowest prices they can obtain.

The Commission's authority to treat small producers as a separate class—because of their unique "problems and public functions" (*Permian, supra,* 390 U.S. at 787)—is settled. The Commission properly determined that Order No. 428 would result in increased ex-

ploration with only a minimal increase in the price of gas to the consumer, since small producers, though responsible for most of the exploration, account for only about 10.5 percent of the gas transported by interstate pipelines.

The order does not unfairly burden pipelines by requiring them to show that their purchased gas costs are reasonable. That obligation is imposed by Section 4(e) of the Act, 15 U.S.C. 717c(e), and pipelines have always been required to demonstrate the reasonableness of their costs. Nor is the standard vague. Apart from their familiarity with its application in other contexts, the pipelines are given further guidance by the order, which specifies two field price factors that the Commission will weigh in determining the reasonableness of purchased gas costs.

The Commission recognizes that this plan is experimental and must be closely monitored. It should be given an opportunity to determine whether the experiment is an appropriate solution for some of its "intensely practical difficulties" (*Permian Basin Area Rate Cases*, 390 U.S. 747, 790) in assuring an adequate supply of gas at reasonable prices.

## ARGUMENT

### THE FEDERAL POWER COMMISSION HAS AUTHORITY TO EXEMPT SMALL PRODUCERS FROM CERTAIN FILING REQUIREMENTS UNDER THE NATURAL GAS ACT AND TO REGULATE INDIRECTLY THE RATES AT WHICH SUCH SMALL PRODUCERS MAKE INTERSTATE WHOLESALE SALES BY DETERMINING, IN PIPELINE RATE PROCEEDINGS, WHETHER THE PIPELINES' COSTS OF PURCHASING GAS FROM SMALL PRODUCERS ARE REASONABLE

#### A. THE DECISION OF THE COURT OF APPEALS RESTS UPON A MISINTERPRETATION OF THE COMMISSION'S ORDER

In the court of appeals' view, the "essential flaw in the Commission's plan" (Pet. App. 12a) is that Order No. 428 would permit small producers to sell natural gas at rates that may be "unjust" or "unreasonable" in violation of Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c and 717d, and that it therefore amounts to an "abdicat[ion of the Commission's] regulatory responsibility in derogation of the purposes and mandatory terms of the statute" (*id.* at 12a–13a). We submit that the Commission's plan has no such flaw. It does not abandon the "just and reasonable" standard of Sections 4 and 5; rather, it establishes an innovative method of indirect regulation, which ensures both that small producers' rates meet the statutory standard and that small producers are encouraged "to increase their exploratory efforts which are so important to the discovery of new sources of gas" (App. 137).

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The Commission emphasized that its action was *not* "deregulation of sales by small producers" (App. 138). Such sales "*shall* be regulated" (App. 137; emphasis added). In lieu of the traditional rate review procedures, however, the Commission established the following regulatory plan.

(1) To encourage exploratory activity by small producers and "to facilitate [their] entry * * * into the interstate market" (App. 137), small producers will be granted, upon application, blanket certificates authorizing them to sell gas at whatever contract rates they are able to negotiate.[8] Those rates may be collected without refund obligation (App. 142, 143, 242); the small producers may therefore rely upon them in planning their exploratory activity.

(2) The negotiated rates are not, however, insulated from Commission review. That review is undertaken in rate proceedings instituted by pipelines and large producers that purchase gas from small producers. The pipelines and large producers are permitted under the order to seek rate increases "tracking" the small producers' rate increases. The tracking increases, like the small producers' rates, may be collected without refund obligation, but only to the extent that the small producers' rates—*i.e.*, the pipeline's purchased gas costs—are not themselves "unreason-

[8] The rate may not, however, exceed the established area maximum rate if it is brought above the maximum rate by operation of certain impermissible price escalation provisions (App. 138, 149–150). See 18 C.F.R. 154.93; *Federal Power Commission* v. *Texaco, Inc.*, 377 U.S. 33.

ably high" (App. 140, 142).[9] A tracking increase which is based on "unreasonably high" small producer rates may be suspended by the Commission and is subject to reduction and refund (App. 142, 143). Since the pipeline cannot itself obtain a refund from the small producer, it has an incentive to negotiate contract rates that are as low as possible, and "the market mechanism * * * will be protective of consumer interests" (App. 143).

(3) If the Commission determines in a pipeline proceeding that a small producer's contract rates are unreasonably high, it remains free to initiate a separate proceeding under Section 5(a) of the Act to consider ordering a prospective reduction of the rate. Nothing in the order forecloses such prospective reduction; indeed, the Commission stated its intention "to review the prices established in new contracts or contract amendments relating to sales by small producers to assure the reasonableness of the rates charged by such producers" (App. 145).

The heart of this regulatory plan is that the Commission determines, in the pipeline or large producer

[9] There are other limitations, but they do not bear directly on the issues in this case. A pipeline may file a special tracking application without the usual supporting documentation only if the small producers' rate increases have affected the pipeline's average cost of purchased gas by at least one mill per Mcf (App. 143). A large producer, ordinarily bound by maximum area rates and moratoria on filing rate increases, may nonetheless apply for tracking increases, but only if the increases are permitted by the producer's contracts with its purchasers (App. 140, 240) and only if the differential between its purchase and resale prices is "consistent with prevailing price differentials in the area" (App. 140).

rate proceeding, whether the small producers' prices are "unreasonably high." In effect, this is the full equivalent of the statutory "just and reasonable" standard. Order No. 428 specifies that the reasonableness determination would include "appropriate comparisons" of the contract price with two market factors: the "highest contract prices for sales by large producers"[10] and "the prevailing market price for intrastate sales in the same producing area" (App. 142).

The court of appeals read the Commission's order as tying the reasonableness determination *exclusively* to these two factors. It stated (Pet. App. 12a):

> Whether or not these two factors would establish precise boundaries on acceptable rates, the Commission has clearly tied its determination to factors which it does not regulate or which derive solely from market forces. * * *

This is the basis of the court's view that, "even granting the legitimacy of indirectly regulating small producer rates, the standards set forth in Order No. 428 have not been demonstrated to have any relationship at all to the statutory standard" (*id.* at 12a, n. 20),

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[10] Large producers frequently contract to sell their gas to pipelines at rates that exceed the applicable area maximum rate. Although the Commission attaches conditions to its Section 7 certification of such sales to limit the rate to the maximum for the area, the contract rate has independent significance. First, if area ceiling rates are raised, the producer can increase its rates only if the contract permits such an increase. Second, unless an area moratorium is in effect, the producer can seek to increase its rates above the area ceiling; though the Commission would suspend any such rate pending a hearing under Section 4(e), the producer would be free to collect the higher rate in the interim, subject to refund.

and that "the Commission here abandoned *any* future rate review under the 'just and reasonable' standard" (*id.* at 13a, n. 21; emphasis in original).

But the order does not imply that the two stated factors are the *only* ones that may be considered. To the contrary, the standard is one of reasonableness, and the order specifies that in applying that standard "[t]he Commission shall consider *all relevant factors*" (App. 142; emphasis added). The two unregulated market price considerations are among those "relevant factors" that the Commission will take into account. They were separately identified in the order, not because they were intended to have necessarily controlling importance, but because the Commission wished to signal a departure from its traditional practice of subordinating field prices to other factors in fixing area rates. See, *e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 792, upholding the Commission's rejection of a "contention that area rates should be derived from field, or contract, prices." [11]

The order was thus designed to put producers and pipelines on notice that in the context of small producer rate increases, the field prices *would* be considered along with the traditional elements of a rate-

[11] *Permian* did not hold, however, that "field prices" are irrelevant in determining just and reasonable rates, only that the Commission "was not compelled to adopt field prices as the basis of it computations of area rates" (390 U.S. at 795). Indeed, the court stated that "records in subsequent area proceedings may more clearly establish that the market mechanism will adequately protect consumer interests" (*ibid.*).

base formula. As the Commission stated in Order No
428–B (App. 246):

> The standard * * * provides pipelines with
> more concrete guide for their future action
> than would exist in the absence thereof. Simpl
> put, the Commission wanted the pipelines t
> know in advance the boundaries within whic
> they could freely contract with small producer

In concluding, contrary to the terms and effect o the order, that the Commission's plan amounted t "*non*regulation" of small producers' rates (Pet. Ap 16a, 17a), the court of appeals was apparently misle by one statement in Order No. 428 and another in th Commission's brief in the court of appeals. The ord stated that the Commission "disagree[s] with the argu ment that the provisions of Sections 4, 5 and 7 of th Act * * * are mandatory and leave no room for ad ministrative judgment and discretion" (App. 136 The court viewed this as a claim that "the FPC ca simply choose not to regulate rates" (Pet. App. 14a

In context, however, it was only a rejection of th argument that the Act leaves no room for departu from the traditional method of *direct* regulation. I deed, in the next paragraph of the order, the Com mission unambiguously stated that "existing and fu ture sales of small producers *shall* be regulated (App. 137; emphasis added). The Commission h not asserted any authority "not to regulate rates (Pet. App. 14a); it has sought only to adopt a ne method of regulation designed to meet present ex gencies.

The statement in the Commission's brief was similarly read out of context. In the section of the brief showing that Order No. 428 complied with the applicable provisions of the Administrative Procedure Act, the Commission addressed the contention that the APA's formal adjudicatory procedures should have been invoked because the order was based on Sections 4 and 5 of the Act. The Commission's response was that the order was *not* based on Sections 4 and 5 in the sense required to invoke the formal hearing provisions of the APA, because the "order does not purport to determine the just and reasonable rates for sales by small producers" (Br. 35). This is not, as the court viewed it (Pet. App. 14a), a concession that the "just and reasonable" standard has been abandoned. It is only a statement that Order No. 428, while establishing a new procedure for regulating small producers' rates, was properly issued without formal adjudicatory proceedings because it did not itself *fix* the rates of any producer.[12]

Order No. 428 is, therefore, quite different from the order the court of appeals thought it was setting aside.

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[12] We do not mean to suggest that an order which does fix producer rates must always follow a formal hearing. In an area rate proceeding, for example, where "[n]o effort [is] made to single out any particular [party] for special consideration based on its own peculiar circumstances" (*United States* v. *Florida East Coast Railway Co.*, 410 U.S. 224, 246), the Commission may properly proceed without a formal hearing. See *Phillips Petroleum Co.* v. *Federal Power Commission*, 475 F. 2d 842 (C.A. 10), pending on petition for a writ of certiorari, No. 73-91; *Mobil Oil Corp.* v. *Federal Power Commission*, C.A.D.C., No. 72-1471, decided July 11, 1973.

The order does not deregulate sales by small producers, does not abandon the statutory "just and reasonable" standard, and does not tie small producers' prices "to the free market, by administrative agency fiat" (Pet. App. 16a). Rather, it establishes for small producers a method of indirect producer rate regulation at the pipeline level, it provides for a determination of the reasonableness of the rates based in part upon field prices, and it ensures both that the ultimate consumer is fully protected against the effects of unreasonably high small producer rates and that the pipelines have a strong incentive to negotiate for producer rates that are sufficiently low to permit them to track the rates without refund obligations.

## B. THE COMMISSION MAY PROPERLY REGULATE SMALL PRODUCERS' RATES INDIRECTLY ON AN EXPERIMENTAL BASIS

The remaining question—whether the Natural Gas Act bars the Commission from regulating small producers' sales indirectly at the pipeline level—was not reached by the court of appeals, because it thought that the Commission's order provided for "*non*regulation" (Pet. App. 16a, 17a) rather than indirect regulation. The court did acknowledge, however, that indirect regulation "might" be adequate under the statute "if the Commission had provided that small producer rates could only be passed along on resale as legitimate costs if they met the 'just and reasonable'

standard" (*id.* at 10a).[11] That, as we have shown, is precisely what the Commission's order does provide.

*1. The Commission's order should be upheld if the regulatory plan it establishes is reasonably designed to result in just and reasonable small producer rates.*

There is nothing in the Act that requires the Commission to regulate producers' rates directly or to employ *any* particular regulatory method. See *Southern Louisiana Area Rate Cases,* 428 F. 2d 407, 415–416, n. 9 (C.A. 5), certiorari denied, 400 U.S. 950. "[R]ate-making agencies are not bound to the service of any single regulatory formula" (*Permian, supra,* 390 U.S. at 776–777). Section 4(a) of the Act directs only that producers' rates "shall be just and reasonable." It does not specify the means by which that result is to be accomplished but entrusts that determination to the Commission's expert judgment. Thus, "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling" (*Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602). The Commission is "permitted, unless [its] statutory authority otherwise

[11] The court added that it might then doubt "the validity of subjecting the pipelines and large producers, who have made *unrefundable* payments to small producers, to the risk of *later* Commission determination, under such an imprecise standard, that the rates paid could not be passed along as legitimate costs" (Pet. App. 10a, n. 17; emphasis in original). We show below that the standard of reasonable costs, traditionally applied in pipeline rate proceedings, is not impermissibly vague.

plainly indicates, 'to make the pragmatic adjustments which may be called for by particular circumstances'" (*Permian, supra,* 390 U.S. at 777, quoting from *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 586).

Section 16 of the Natural Gas Act, 15 U.S.C. 717o, "assures the [Commission] the necessary degree of flexibility" (*Federal Power Commission* v. *Louisiana Power & Light Co., supra,* 406 U.S. at 642) to make those "pragmatic adjustments." It provides:

> The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. * * * For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. * * *

In construing the scope of the Commission's authority under Section 16, this Court has stated that "the width of administrative authority must be measured in part by the purposes for which it was conferred" (*Permian, supra,* 390 U.S. at 776). The Commission's responsibility for regulating the wholesale distribution of making, "a balancing of the investor and the consumer interests" (*Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 603) to the end that prices are only as high as is necessary to ensure an adequate supply of gas for the public and a fair return for the investor. "Surely ~~the Commission's broad responsibilities there-~~

natural gas in intersta
Commerce requires, in

fore demand a generous construction of its statutory authority" (*Permian, supra,* 390 U.S. at 776); it must "be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties" (*id.* at 790).

It is in light of these principles that Order No. 428 should be viewed. The test of its validity under the Act is whether the plan it establishes is reasonably designed to ensure just and reasonable small producer rates. Like any other exercise of the Commission's judgment in its efforts to achieve the statutory objectives, the order is entitled to a "presumption of validity" (*Permian, supra,* 390 U.S. at 767; *Hope Natural Gas Co., supra,* 320 U.S. at 602), and "he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences" (*ibid.*). Respondents have not overcome that presumption.

*2. The order establishes a reasonable plan to stimulate exploration, increase supply, and maintain reasonable price levels.*

The court of appeals aptly summarized the regulatory problem that led to the issuance of Order No. 428:

> A critical gas shortage * * * faces the nation. The Federal Power Commission is confronted with an ever-increasing regulatory burden—and limited resources. These combine to produce administrative delay and threaten the Commission's ability adequately to control natural gas prices. [Pet. App. 5a–6a.]

Thus, the Commission's responsibility is to try to ensure an increased supply of natural gas while avoiding unreasonably high prices to consumers.

The Commission's efforts to meet this difficult responsibility have necessarily involved innovative and imaginative use of the characteristic flexibility of the administrative process. For example, it has set maximum producer rates on an area-wide basis; it has sought to use price functionally to stimulate exploration and dedication of reserves to the interstate market; and it has exempted the small producers from some of the usual filing requirements under the Act and the regulations. More recently, it commenced rulemaking proceedings to set just and reasonable rates on a *nation*-wide basis (38 Fed. Reg. 10014 and 14295).

In Order No. 428, the Commission's focus was upon the small producers. As the court of appeals observed (Pet. App. 6a), "small gas producers have historically accounted for as much as 80% of new exploration" but only "for 10.5% of the gas put into pipelines * * *." Their difficulty has been that they "have less ready access to the necessary capital than do large producers" (*ibid.*).

The Commission's plan is an innovative effort to stimulate small producer exploration with only such minimal price increases to consumers as are just and reasonable in the circumstances. Order No. 428 relieves small producers from the costly burden of regular administrative proceedings, and thereby frees the Commission to give greater attention to the large producers. To assure the small producers an adequate and stable flow of revenue

to facilitate their exploratory activity, the order permits the producers to collect their negotiated contract prices subject only to the risk of prospective reduction by the Commission in appropriate cases.

Since small producers account for only a small proportion of the gas transported by interstate pipelines (App. 137), the Commission had reason to anticipate that the impact on consumers of any higher prices that might result would be minimal (App. 2). To ensure that the market mechanism works effectively and that prices do not rise unreasonably, however, the order provides that purchasers from small producers may pass on to their customers only that part of a producer rate increase that is not unreasonably high. Were it otherwise, the pipeline purchasers would have less incentive to bargain hard, for they would be free to pass on even unreasonably large increases. The Commission did not foreclose prospective reduction of a small producer's rate that has been found unreasonably high in a pipeline rate proceeding.

Finally, the order provides that a small producer may not abandon the sale of gas under any contract, even after the contract has expired, without first obtaining authorization from the Commission under Section 7(b) of the Act, 15 U.S.C. 717f(b).[14] This means

[14] Section 7(b) prohibits abandonment of any service "without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment."

that the Commission will be able to exert a further stabilizing influence over prices. If a producer and a pipeline cannot agree on the terms of a new contract, the Commission remains free to determine that the public convenience and necessity would not be served by an abandonment. The producer would then be required to continue supplying gas at the price stipulated in the old contract, unless it applied to the Commission for an increase under Section 4(d) of the Act, 15 U.S.C. 717c(d).

The court of appeals took exception to the Commission's plan only because of its mistaken assumption that the order would remove all constraints on small producer rates. Even so, it characterized the plan as "imaginative" (Pet. App. 5a), and stated that "[t]he Power Commission has made a conscientious and intelligent effort to cope with an enormous national problem" (*id.* at 17a). That effort is necessarily experimental, for it cannot now be known with complete confidence whether it will produce all the desired results. The Commission fully recognizes its obligation to monitor the plan closely, and it specifically stated in Order No. 428 that, "[i]n the event we determine that this approach is inimical to the interests of consumers, we shall take further action to protect the consumers" (App. 145).

Order No. 428 is thus a reasonably designed plan to encourage the discovery of new gas reserves and the dedication of those reserves to the interstate market at prices that are just and reasonable. It strikes a proper balance between the investor and consumer

interests. Although the order departs from the usual regulatory method of direct rate review, its objective—an adequate supply of gas at reasonable rates—is the same. Particularly in view of the urgent gas shortage, the Commission should be afforded a "reasonable opportunity" (*Permian, supra,* 390 U.S. at 790) to determine through experience whether this pragmatic adjustment in its method of regulation is, in practice as well as in theory, "appropriate for the solution of its intensely practical difficulties" (*ibid.*).

*3. Order No. 428 does not treat large producers or pipelines unfairly.*

The Commission's plan excuses small producers from the price constraints imposed upon large producers by the maximum area rate level. The order also eliminates for small producers the risk that they will be ordered to refund any collected rates that are later determined to be unreasonably high. At the same time, pipelines and large producers that purchase from small producers remain subject to the risk of refund if their purchased gas costs—*i.e.,* the negotiated small producer rates—are unreasonably high. Though pipelines and large producers are thus treated differently from small producers, the differences are justified under the Natural Gas Act and do not impose unfair burdens upon pipelines or large producers.

Section 16 of the Act, 15 U.S.C. 717*o,* gives the Commission broad power to establish different classes of persons subject to its jurisdiction and to treat the classes differently:

> For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. * * *

The only limitation upon that authority is that the Commission must find the rules and regulations to be "necessary or appropriate to carry out the provisions of this Act" (*ibid.*). The treatment of each of the classes in Order No. 428 was properly found by the Commission to be "necessary and appropriate for the administration of the Natural Gas Act" (App. 145).

a. The Commission's authority to treat small producers as a separate class is settled. This Court in *Permian* held that "[t]he problems and public functions of the small producers differ sufficiently to permit their separate classification" (390 U.S. at 787).[15]

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[15] The Court described the unique problems of small producers as follows (390 U.S. 784–785):

"Although the resources of the small producers are ordinarily more limited, their activities are characteristically financially more hazardous. It appears that they drill a disproportionately large number of exploratory wells, and that these are frequently in areas in which relatively little exploration has previously occurred. Their contribution to the search for new gas reserves is therefore significant, but it is made at correspondingly greater financial risks and at higher unit costs. The record before the Commission included evidence that, for this and other reasons, small producers have regularly suffered higher percentages of dry wells, and higher average costs per Mcf of production. At the same time, the Commission found that small producers are the source of only a minor share of the total national gas production, and that the prices they have received have followed closely those obtained by the larger producers." [Footnotes omitted.]

In that case, the Court upheld small producer exemptions from certain filing, reporting, and price adjustment obligations.

The result of the filing and reporting exemptions in the present case is to permit the small producers to exceed the area maximum rate level. Section 16, 15 U.S.C. 717*o*, authorizes the Commission to permit different rate levels where they are "necessary or appropriate to carry out the provisions" of the Natural Gas Act. In *Permian*, this Court accordingly upheld a two-price rate structure under which "two producers, simultaneously offering gas of identical quality and BTU content, may be confronted by different maximum prices" (390 U.S. at 795–796). The Court held that "the statutory 'just and reasonable' standard permits the Commission to require differences in price for simultaneous sales of gas of identical quality, if it has permissibly found that such differences will effectively serve the regulatory purposes contemplated by Congress" (*id.* at 797–798).

Thus, the court of appeals considered it "certainly conceivable" that, "[g]iven the special problems and practices of small producers," the Commission could "set a just and reasonable rate for small producers higher than that for large producers" (Pet. App. 16a). The Commission has not set a higher rate level for small producers in Order No. 428, but it has determined that the reasonableness of small producer rates may depend in part on different considerations and that those rates therefore need not be limited to the area ceilings applicable to large producer rates. We have already explained the basis of the Commission's determination that this approach is a necessary and appropriate means for stimulating exploratory activity.

The court of appeals expressed concern that the Commission might "proceed to establish another class of 'medium' producers, and provide the same or different appropriate exemptions for this new class" (Pet. App. 15a). But this concern was based on its mistaken view that the exemptions established by Order No. 428 would suspend the "just and reasonable" standards of Section 4(a). It stated that, "[i]f Order No. 428 is upheld, no limit appears which could halt gradual erosion of the statutory standard's applicability," and determining rates under the "just and reasonable" test would become "the exception rather than the rule" (*id.* at 16a).

As we have shown, however, Order No. 428 does *not* abandon the statutory standard; it adopts a new technique for applying it. If that technique or a similar one were later deemed appropriate for regulating the sales of some intermediate class of producers, and if the "problems and public functions" (*Permian, supra,* 390 U.S. at 787) of that intermediate class were sufficiently different from those of the remaining classes, then it, too, could be accorded different treatment under the Act. Even if an intermediate classification could *not* be justified, however, that would not be a reason to disapprove the small producer classification established here. If, as we have shown, the Commission's order is consistent with the provisions of the Natural Gas Act, it is no less lawful because a hypothetical order might sometime in the future establish an impermissible classification.

b. The pipelines and large producers have argued that the Commission's order unfairly shifts from pro-

ducers to purchasers the burden of establishing the reasonableness of the producers' rates. They object to the provisions of the order that excuse small producers from refund obligations while permitting purchasers to track only those increased rates that are not unreasonably high. In their view, the Commission was required either to subject the producers to refund obligations or to free the purchasers from such obligations.

Either alternative, however, would undermine the effectiveness of the order. The Commission's plan is designed to assure a stable flow of revenue upon which small producers may depend in undertaking natural gas exploration. Eliminating the risk of refunds is an essential element of that plan.[18] While Section 4(e) of the Act, 15 U.S.C. 717c(e), authorizes the Commission to order refunds, it does not require it to do so.

Similarly, if the purchasers from small producers were free to pass on to their customers even unreasonably high small producer price increases, the market mechanism on which the Commission's order in part relies would be markedly less effective. Purchasers would have a smaller stake in the rate level,

[18] Although the Commission retains the authority to order *prospective* reductions of unreasonably high small producer rates, the disruptive effect of a prospective change, involving no refund of rates already collected, is not likely to be as great as that of a retrospective change. The Commission could properly determine that the countervailing harm that might result from requiring a purchaser to absorb refunds over the whole term of a contract justifies a different rule with respect to prospective reductions.

and market forces would be a less reliable check on rate increases. Requiring pipelines and large producers that purchase from small producers to bear part of the economic consequences of an imprudent bargain is thus central to the scheme of Order No. 428.

The Act does not limit the Commission to regulating rates directly at the producer level. Nor does it guarantee pipelines and other purchasers that they will be entitled to pass on any purchased gas costs, regardless of the reasonableness of those costs. That the Commission has exercised its authority in the past to review producers' rates in producers' proceedings and to permit purchasing pipelines to pass on the approved increases does not mean that it cannot now adopt a different method of regulation. Cf. *Federal Power Commission* v. *Sunray DX Oil Co.*, 391 U.S. 9, 47–52.

What matters under the Act is "the result reached not the method employed" (*Hope Natural Gas Co., supra,* 320 U.S. at 602). Since the Commission's order is reasonably designed to result in rates that are just and reasonable, it should not be disapproved on the ground that the method it establishes would require purchasers to demonstrate that they have entered reasonable contracts. Indeed, as the Commission pointed out in Order No. 428–B, that obligation—embodied in Section 4(e) of the Act [17]—is not a new one for natural gas pipelines (App. 245):

[17] Section 4(e), 15 U.S.C. 717c(e), provides: "At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company * * *."

Ever since the passage of the Natural Gas Act in 1938, pipelines as regulated public utilities have been permitted to include in their cost of service only those operating expenses, including the cost of purchased gas, which are reasonable. While our order [No. 428] placed emphasis on that duty, it did not effectuate any basic change in the pipelines' obligations in this regard. These obligations would exist even if nothing had been said in the order.

c. The pipelines and large producers argue, however, that the standard of reasonableness is impermissibly vague and fails to provide an adequate guide to purchasers in evaluating the risks of entering into a contract at a particular rate. But reasonableness is the statutory standard governing all rate matters under the Natural Gas Act. Companies that are subject to the Commission's jurisdiction can hardly claim unfamiliarity with the standard; the pipelines' rate base has always been limited to reasonable costs.

Moreover, the Commission specifically mentioned two factors that it would consider in determining the reasonableness of a pipeline's purchased gas costs—the "highest contract prices for sales by large producers" and "the prevailing market price for intrastate sales in the same producing area" (App. 142). As the Commission noted, these factors provide "pipelines with a more concrete guide for their future actions" (App. 246).

A purchaser of gas is thus not without the wherewithal to determine the limits of reasonableness. Conscientious consideration of prevailing intrastate prices

and large producer contract prices—together with the currently effective area ceiling rates, any ongoing large producer rate proceedings, and the traditional elements of a small producer's rate base—will permit a gas purchaser to estimate with confidence the limits of a reasonable small producer rate. And the Commission's determinations in future pipeline rate proceedings will, of course, provide further indication of the manner in which the standard will be applied. The Act requires no more; certainly nothing in the Act provides purchasers with a risk-free guaranty either that all their costs will be controlled or that they will be able to pass on to consumers all the costs they incur, however unreasonable those costs may be.

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the court of appeals should be reversed.

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*Solicitor General.*
MARK L. EVANS,
*Assistant to the Solicitor General.*

LEO E. FORQUER,
*General Counsel,*
GEORGE W. MCHENRY, JR.
*Solicitor,*
JOHN R. STAFFIER,
*Attorney,*
*Federal Power Commission.*

DECEMBER 1973.

15 U.S.C. 717, et seq.

# APPENDIX

The Natural Gas Act, 52 Stat. 821, *et seq.*, as amended, provides in pertinent part:

Section 4, 15 U.S.C. 717c:

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and

charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but

not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Section 5, 15 U.S.C. 717d:

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any

rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

Section 7, 15 U.S.C. 717f:

CONSTRUCTION, EXTENSION, OR ABANDONMENT OF FACILITIES; CERTIFICATE OF CONVENIENCE AND NECESSITY; CONDEMNATION PROCEEDINGS

(a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it

may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers,

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extension thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commis-

sion authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on February 7, 1942, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after February 7, 1942. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such man-

ner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization.

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company.

(h) When any holder of a certificate of public convenience and necessity cannot acquire by

contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided,* That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000.

Section 16, 15 U.S.C. 717*o*:

ADMINISTRATIVE POWERS OF COMMISSION; RULES, REGULATIONS, AND ORDERS

The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations

may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

U.S. GOVERNMENT PRINTING OFFICE: 1978

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

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NO. 72-1490

FEDERAL POWER COMMISSION, *Petitioner*

v.

TEXACO INC., ET AL.

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NO. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., *Petitioners*

v.

TEXACO INC., ET AL.

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**On Writs Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit**

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## BRIEF OF RESPONDENT TEXACO INC.

## INTRODUCTORY STATEMENT

Texaco Inc. (Texaco) adopts the descriptions of opinions below, jurisdiction and statutes involved, contained

in the briefs of the Federal Power Commission (Commission) and Dudley T. Dougherty, *et al.*

## COUNTERSTATEMENT OF QUESTIONS PRESENTED

(1) Whether the Federal Power Commission has the power under the Natural Gas Act to exempt from direct rate regulation certain producers of natural gas.

(2) Whether the orders of the Federal Power Commission, exempting certain producers of natural gas from direct rate regulation under the Natural Gas Act, unlawfully discriminate against those natural gas producers whose interstate gas sales remain fully regulated by the Commission.

## COUNTERSTATEMENT OF THE CASE

Texaco hereby submits its brief, supporting the decision of the court of appeals below, which found to be unlawful the Commission's attempt at exemption of small producers from direct rate regulation under the Natural Gas Act.[1] Texaco is a producer and seller of substantial quantities of natural gas in interstate commerce which gas sales are regulated by the Commission. Texaco actively competes at all levels with other natural gas producers. Texaco was aggrieved, therefore, by the Commission's discriminatory and unlawful orders described below.

In its Notice of Proposed Rulemaking issued July 28, 1970, in Docket No. R-393 (35 Fed. Reg. 12,220) the Commission proposed to exempt from regulation under the Natural Gas Act all existing and future jurisdictional

1. 15 U.S.C. §§717 *et seq.*

natural gas sales made by small producers. A small producer was defined as a producer whose total jurisdictional natural gas sales nationwide do not exceed ten million Mcf per year. Comments were filed by interested parties (see App. 14-96) and a conference was held (App. 97-134). On March 18, 1971, the Commission issued its Order No. 428 (App. 135-154) where, *inter alia,* it exempted small producer sales from the direct rate regulatory requirements of Sections 4 and 5 of the Natural Gas Act. Applications for rehearing were filed by various parties which were, in essence, denied by the Commission in its Order No. 428-B, issued July 15, 1971 (App. 242-243).

In its original Notice of Proposed Rulemaking issued July 23, 1970, the Commission proposed to exempt small producers from rate regulation under the Natural Gas Act permitting them to collect their contractually authorized prices for their interstate gas sales. The Commission, however, proposed to continue its regulation under Section 7(b) of the Act stating that small producers would not be permitted to abandon their sales without Commission approval. Additionally, certain reporting requirements were suggested.

In its Order No. 428 the Commission generally followed the proposal set forth in its Notice of Proposed Rulemaking with respect to exemption of small producers from rate regulation. However, the Commission incorporated certain new features not previously proposed whereby the interstate purchaser of a small producer's gas would assume certain regulatory burdens including the responsibility for filing with the Commission its contract with the small producer. Additionally, the Commission indicated that indirect rate regulation of the small pro-

ducer's sales would be accomplished by reviewing the price paid by the pipeline purchaser. If such price failed to meet specified criteria as set forth by the Commission then it would be disallowed in the pipeline's purchased gas cost, resulting in lower rates to the pipeline's customers.

On July 15, 1971, several parties filed in the United States Court of Appeals for the District of Columbia Circuit their petitions for review of Order Nos. 428, 428-A and 428-B. These orders of the Commission were reversed by the court of appeals on December 12, 1972 (Opinion reported at 474 F.2d 416). The court held that the Commission was without authority to exempt small producers from the mandatory requirement of the Natural Gas Act that the rates of all natural gas companies must be regulated directly by the Commission.

## ARGUMENT

### The Federal Power Commission Does Not Have The Authority To Exempt Small Producers From Direct Rate Regulation Under The Natural Gas Act And In So Doing Has Unlawfully Discriminated Against Other Producers

### I. The Commission Has No Power To Exempt Small Producers From The Mandatory Rate Regulatory Provisions Of The Natural Gas Act

As stated in its brief opposing petitions for writs of certiorari filed in this cause, Texaco fully supports the concept of deregulation of *all* natural gas producer sales in interstate commerce. However, the construction of the language of the Natural Gas Act by this Court in the "first *Phillips* case," *Phillips Petroleum Company v. Wisconsin,* 347 U.S. 672 (1954), established the rule that

all producers' sales in interstate commerce must be regulated by the Commission. The above decision and subsequent decisions lead Texaco to believe that relief from direct rate regulation under the mandatory provisions of Section 4 of the Act of any natural gas producer (or "class" of producers) can be granted only by Congress, rather than the Commission.

As stated by the court of appeals decision below at 474 F.2d 419:

> "Ever since Phillips Petroleum Co. v. Wisconsin, the Commission, even against its own will, has had a judicially recognized duty to assume 'jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce"[11] to insure that all such rates comply with the statutory standard.
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> ---
>
> 11. 347 U.S. 672, 682, 74 S.Ct. 794, 799, 98 L.Ed. 1035 (1954). (Emphasis added.) It should be noted that Justice Clark, in dissent, conceded that '[o]n its face, this language brings every gas operator, *from the smallest producer to the largest pipeline*, under federal regulatory control,' 347 U.S. 672, 691, 74 S.Ct. 794, 804 (emphasis added)."

The Commission in exempting the small producer from its rate regulatory jurisdiction relied upon Sections 4, 5, 7 and 16 of the Act. These provisions, however, do not afford the Commission any discretion as to which natural gas producers it may regulate and which natural gas producers it may not regulate. For instance, Section 4(a) of the Act states in part that "*all* rates and charges" by "*any* natural gas company shall be just and reasonable." Section 4(c) of the Act also states that "[u]nder such rules and regulations as the Commission may prescribe, *every* natural-gas company shall file . . . in such form as the Commission may designate, . . . *all* rates and charges

. . ." (emphasis added). While it is recognized that Section 16 of the Act provides that ". . . the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters," it is clear that classification of producers for regulatory purposes is an entirely different matter from exemption of certain producers from such regulation, especially in view of the mandatory language of Section 4 of the Act. Concurring with this analysis, the court of appeals in the present case stated:

> "However, the FPC must act 'within the ambit of [its] . . . statutory authority.' The Commission may not ignore the command of Section 4 (15 U.S.C. § 717 c (a)) . . ." (474 F.2d 419) (note omitted)

The Commission and the courts since the outset of the Commission's regulation of natural gas producers following the previously mentioned "first *Phillips* case" have considered and rejected the total exemption of the small producer. Thus, in adopting regulations to implement its regulation of producers following the *Phillips* case the Commission rejected the suggestion of exemption of small producers.[2]

Several years later the argument of exemption of small producers was likewise rejected in *Saturn Oil & Gas Co. v. Federal Power Commission,* 250 F.2d 61 (10th Cir. 1957), *cert. denied* 355 U.S. 956, wherein the court stated:

> "There is nothing in the Natural Gas Act which makes its applicability depend on the size or the

2. Order No. 174-B, Docket Nos. R-138, R-137, 13 F.P.C. 1576, 1577 (1954).

integration of the gas operator. The Phillips decision holds that the Act applies to all wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations." (250 F.2d at 67)

In considering this question in its first area rate proceeding, the Commission in *Permian* recognized the legal impediments to exemption of small producers and concluded that it was not "necessary or desirable to provide outright exemption."[3] The Commission, however, exercised its permissible authority under Section 16 of the Act to classify certain small producers for the purpose of applying different regulatory standards to such producers. This approach, which was not the equivalent of exemption from rate regulation, was all that was approved by the Supreme Court in its *Permian* decision (*Permian Basin Area Rate Cases,* 390 U.S. 747, 784-87 (1968)). As pointed out by the court of appeals in the present case at 474 F.2d 420, "the 'exemptions' approved there were from detailed filing requirements, not from all regulation."

In support of its exemption of small producers the Commission has relied upon the suggestion made by Justice Clark in *F.P.C. v. Hunt,* 376 U.S. 515, 527 (1964). The *Hunt* case, which involved the Commission's power to condition a producer's temporary certificate, did not involve questions of exemption of any producers. The Court, however, was concerned over administrative delays in issuing permanent certificates to producers; hence Justice Clark's suggestion that the Commission investigate clearing its backlog of cases by exemption procedures

3. *Area Rate Proceeding (Permian Basin Area),* Docket Nos. AR61-1, *et al.,* Opinion No. 468, 34 F.P.C. 159 (1965).

such as utilized by the National Labor Relations Board. Ostensibly in support of his suggestion, Justice Clark cited *Guss v. Utah Labor Relations Board*, 353 U.S. 1, 3-4 (1957).

A review of the National Labor Relations Act[4] and the Fair Labor Standards Act[5] under which the exemption practices referred to by Justice Clark were effected shows that the National Labor Relations Board's jurisdiction is discretionary not mandatory. In the *Guss* case cited by Justice Clark, the Court found that these labor acts give the Board extensive jurisdiction over labor controversies affecting interstate commerce but *do not require* the Board to assert at all times the full measure of its jurisdiction. Thus, the Board, is "empowered" but is not "directed" to prevent unfair labor practices (29 U.S.C. § 160(a)). Likewise, the Board is given the "power" rather than the "duty" to issue complaints upon the receipt of appropriate charges (29 U.S.C. § 160(b)). These discretionary powers of the Board are simply not comparable with the mandatory rate provisions of the Natural Gas Act and may not be used as the basis for exemption of any class of producers from direct rate regulation.

The court of appeals in this case fully agreed with the above analysis, and stated at 474 F.2d 420:

> "Only this year the Supreme Court specifically contrasted the FPC and the NLRB, suggesting that the former's jurisdiction will be broadly construed so that there are no 'gaps' in the Natural Gas Act's

4. 29 U.S.C. §§151, *et seq.*

5. 29 U.S.C. §201.

'comprehensive and effective regulatory scheme."[13] Further, the trials and experimentations which this court has previously approved have always been trials of new procedures consistent with the terms of the Natural Gas Act, not experimental attempts to amend, avoid or ignore these provisions.[14]

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13. FPC v. Louisiana Power & Light Co., 406 U.S. 621, 631, 92 S.Ct. 1827, 32 L.Ed.2d 369 (1972).

14. Deregulation is decidedly not one of the 'policy decisions of the type [the FPC] . . . was created to make.' See Public Service Commission v. FPC, 467 F.2d 361, 367."

Having demonstrated above that exemption of any class of producer from direct rate regulation is unlawful, it is unnecessary to speculate on the effectiveness of the scheme of admittedly "indirect review" (Commission's Brief, p. 10) which is advocated at pages 15-20 of the Commission's brief as a means of insuring consumer protection.

## II. The Commission's Orders Exempting Small Producers Unlawfully Discriminate Against Large Producers

The Commission in Order No. 428 classified all regulated independent producers into two categories; those having total interstate gas sales to and including ten million Mcf annually and those whose interstate sales are in excess of ten million Mcf per year. Texaco, which falls into the latter, nonexempt group, submits that there is no factual basis for such a distinction.

All producers irrespective of their size compete directly with one another at all levels of the natural gas industry. When the Commission by its orders frees a certain segment of the natural gas producing industry from rate

regulation, such producers immediately acquire an unfair advantage in this highly competitive enterprise. An example of the competitive advantage enjoyed by a non-regulated producer is in the acquisition of leases. A landowner logically has no preference between those bidding to lease his mineral rights based on the size of the potential lessee's interstate gas sales. What is likely to influence the lessor's decision is the fact that if natural gas is found on his property, the lessee may sell such gas at prices in excess of the Commission's established area ceiling rate if the lessee is a "small producer."

An undue preference or advantage to the exempt producers is unlawful under the terms of Sections 4(b) and 5(a) of the Act.[6] Section 4(b) requires that the Commission in its rate regulation not permit the granting of "any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage."[7] Section 5(a) similarly obligates the Commission to correct any situation where it finds "that any rule, regulation, practice, or contract affecting [a] rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential. . . ."[8]

In *Episcopal Theological Seminary v. Federal Power Commission*, 106 U.S. App. D.C. 37, 269 F.2d 222 (1959), *cert. denied* 361 U.S. 895 the court recognized that the Commission could not discriminate in its rate treatment between producers which sold jurisdictional gas under similar circumstances. That case involved an issue

6. 15 U.S.C. §§717c(b) and 717b(a).

7. 15 U.S.C. §717c(b).

8. 15 U.S.C. §717d(a).

as to whether rate increases by certain producers in a gas field from 13 cents per Mcf to 13.5 cents per Mcf were "just and reasonable" under Section 4 of the Act. One of the arguments raised by the producers was that the Commission in an earlier order, had found that an increase to 13.5 cents per Mcf in the same field by another producer was just and reasonable. The court observed that the Commission could not permit one producer in the field to collect the 13.5 cents rate while denying it to others. As the court stated:

> "Obviously, any such arbitrary differentiation without any distinction as to the proceeding is not permissable.[28]
>
> 28. Cf. Atlantic Seaboard Corp. v. Federal Power Comm., 4 Cir., 201 F.2d 568, 570." (269 F.2d at 237)

The court went on, however, to note that the Commission had already undertaken to "correct" its error in permitting the 13.5 cents rate to be collected by the institution of a rate investigation under Section 5(a) of the Act. This case clearly establishes that producers must be afforded rate regulation on a uniform and nondiscriminatory basis.[9]

Texaco, therefore, submits that the Commission has abused its discretion in promulgating an order which, contrary to the provisions of Sections 4(b) and 5(a) of the Act, unfairly discriminates against large producers. In view of the fact that the first portion of the argument in this brief demonstrates the Commission's efforts to dis-

9. *Also see Federal Trade Commission v. Crowther*, 139 U.S. App. D.C. 137, 430 F.2d 510 (1970) where the court reversed an agency decision which involved unequal regulatory treatment between parties in virtually identical circumstances.

regard the mandatory provisions of the Act, such abuse of discretion is particularly cognizable by the Court when the Commission's action on its face is unlawful (Cf. *Scanwell Laboratories, Inc. v. Shaffer*, 137 U.S. App. D.C. 371, 424 F.2d 859 (1970)).

## CONCLUSION

For the reasons stated above, the judgment of the court of appeals, invalidating the small producer exemption, should be affirmed.

Respectfully submitted,

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In the

# Supreme Court of the United States

OCTOBER TERM, 1973

No. 72-1490

FEDERAL POWER COMMISSION,

*Petitioner,*

*v.*

TEXACO, INC., et al.,

*Respondents.*

No. 72-1491

DUDLEY T. DOUGHERTY, et al., Co-Executors of the ESTATE OF MRS. JAMES R. DOUGHERTY, et al.,

*Petitioners,*

*v.*

TEXACO, INC., et al.,

*Respondents.*

*On Writ of Certiorari to the United States Court of Appeals For the District of Columbia Circuit*

## BRIEF FOR RESPONDENT JAMES M. FORGOTSON, SR.

## OPINION BELOW

The Opinion of the Court of Appeals (FPC Pet., pp. 3a-22a)[1] is reported at 474 F. 2d 416 (D. C. Cir. 1972). The initial

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[1] Reference "FPC Pet." is to the FPC's Petition for Writ of Certiorari in No. 72-1490. Reference "App." refers to the separately bound joint Appendix in this Court.

order (No. 428) of the Federal Power Commission (App. 135-154), its Order (No. 428-A) of Amendment (App. 159-161), and its Order (No. 428-B) denying rehearing (App. 238-253) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

## JURISDICTION

The Judgment of the Court of Appeals was entered December 12, 1972 (FPC Pet., pp. 23a-25a). The Federal Power Commission's (hereafter called FPC) Petition for Rehearing was denied on February 5, 1973 (FPC Pet., pp. 26a-28a). The Petition for a Writ of Certiorari was filed on May 3, 1973 and was granted on October 9, 1973 (App. 254).[2] The jurisdiction of this Court rests on 28 U.S.C. § 1254(1) and § 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

## QUESTIONS PRESENTED

Does the FPC have authority to exempt certain independent producers[3] of natural gas from certain filing requirements and direct rate regulation with respect to interstate wholesale sales[4] of natural gas under provisions of the Natural Gas Act of 1938, as amended, 15 U.S.C. §§ 717-717w (hereafter called the Natural Gas Act) by, among other things, shifting the burden of establishing the justness and reasonableness of rates

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[2] The Court concurrently granted the Petition in No. 72-1491 — which sought review of the same Judgment of the Court of Appeals — and ordered the cases consolidated for oral argument (App. 254).

[3] Independent producers are natural gas producers not affiliated with an interstate natural gas transmission pipeline company.

[4] Wholesale sales of natural gas for interstate transmission, consumption or use.

for said sales from said producers to the purchasers[5] despite the clear statutory language to the contrary? If there is statutory authority for the above-described scheme of regulation, does any and all FPC regulation[6] of any independent producers of natural gas with respect to their interstate wholesale sales of natural gas constitute such invidious discrimination that it violates the Fifth Amendment to the Constitution of the United States and negate state conservation laws with respect to natural gas so that it violates the Tenth Amendment to the Constitution of the United States, making the above mentioned orders or any orders of the FPC affecting independent producers of natural gas void?

## STATUTE AND CONSTITUTIONAL PROVISIONS INVOLVED

Sections 4, 5, 7 and 16 of the Natural Gas Act, 15 U.S.C. §§ 717c, 717d, 717f and 717o are set forth in FPC Pet., pp. 85a-93a. U. S. Const. Amend. V and Amend. X are set forth in Addendum A to this brief, *infra*, p. A-1.

## STATEMENT

This case involves judicial review of Orders 428 (App. 135-154) and 428B (App. 238-253) of the FPC, issued March 18, 1971 (App. 135-154). In summary, said Orders exempt completely from direct rate regulation by the FPC under the Natural Gas Act all existing and future interstate wholesale sales of natural gas by independent producers with

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[5] Purchasers are interstate natural gas transmission pipeline companies or other producers who buy natural gas for subsequent resale to the above mentioned pipeline companies.

[6] Application of the Natural Gas Act and concomitant FPC regulation, including rate regulation.

less than ten (10) billion cubic feet of interstate wholesale sales per year.

## A. Background

In 1954, this Court in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 (1954) held that interstate wholesale sales of natural gas by independent producers of natural gas were subject to the Natural Gas Act, the Rules and Regulations of the FPC promulgated thereunder, and the regulatory jurisdiction of the FPC. Among other things, that decision subjected the above-mentioned independent producers with respect to interstate wholesale sales of natural gas to rate regulation and various other limitations on their freedom to contract, such as restriction of their right to terminate selling gas under a gas sales contract after said contract had expired by its own terms.

A relatively complex regulatory program evolved over the next 16 years to regulate independent producers with respect to interstate wholesale sales of natural gas. Meanwhile, for whatever cause, a natural gas shortage developed in the United States. As part of an overall effort to cope with this shortage and to attract more natural gas to the interstate market, i.e. sale for transmission into or consumption or use in states other than the state in which said gas is produced, the FPC entered into the R-393 Rulemaking Procedure (App. 1-13) which led to the promulgation of Orders 428 and 428B described above.

## B. Proceedings Before The Commission

The Orders in question arose from the FPC's Rulemaking

Proceeding, Docket No. R-393, to exempt certain independent producers from regulation, notice of which was filed on July 23, 1970 (App. 1-13).

James M. Forgotson, Sr. (hereafter called Forgotson) is an independent producer with production and interstate wholesale sales of natural gas in Louisiana and Texas. Within the deadline set by the FPC for filing written comments on the proposed Rule, Forgotson objected to the proposed rule on the ground that the FPC lacked jurisdiction to issue all regulatory orders under the Natural Gas Act affecting any independent producer of natural gas, because such jurisdiction subjects such independent producers to inappropriate federally administered public utility treatment and discriminates against such producers in a manner which is repugnant to the Fifth Amendment to the Constitution of the United States (App. 57-72), See *Morey v. Doud,* 354 U.S. 457 (1957).

Forgotson then, through his attorney, attended the conference regarding the merits of the proposed rule held by the FPC on December 8, 1970 (App. 97-134).

The FPC issued Order No. 428 on March 18, 1971 (App. 135-154). On March 31, 1971, Forgotson filed an Application For Rehearing (App. 155-158), protesting against the jurisdiction of the FPC to issue this or any other order affecting independent producers, which the FPC denied.

Forgotson sought judicial review, pursuant to Section 19(b) of the Natural Gas Act of Order No. 428 and Order No. 428B, which denied Applications For Rehearing on Order 428 (App. 238-253).

### C. The Decision Below

Upon judicial review of the validity of Orders 428 and 428B the United States Court of Appeals for the District of Columbia Circuit, with one judge dissenting, set aside the above-mentioned FPC Orders after concluding that the FPC in issuing such Orders had exceeded its authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).

That court's decision turned upon an analysis of specific provisions of the Natural Gas Act, namely, Sections 4, 5, 7 and 16 (FPC Pet., pp. 85a-93a). The court concluded, in effect, that the regulation of rates for interstate wholesale sales of natural gas was *mandatory*, and not discretionary or permissive, regardless of the volume of said sales by an independent producer in a given time period. In that connection, the FPC's Section 16 classification powers would not permit the exemption of the interstate wholesale sales of natural gas by certain independent producers from direct rate regulation under Section 4 of the Natural Gas Act (FPC Pet., pp. 7a-10a). That being the case, the court held that the FPC's Order Nos. 428 and 428B represented a clear-cut abdication of the FPC's statutory duty to assure that *all* regulated rates for interstate wholesale sales of natural gas, including those of the independent producers whose sales were exempted from direct rate regulation under Orders 428 and 428B, be "just and reasonable" (FPC Pet., pp. 10a-16a). This departure from statutory duty and standards through the so-called "indirect" mode of regulation at the pipeline or purchaser level was held to be contrary to the provisions of the Natural Gas Act.

> "Nothing at all insures that those levels (of rates allowed to be passed on to consumers) will be 'just' or 'reasonable.'

That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a-13a).

## SUMMARY OF ARGUMENT

As will be shown hereafter, the judgment below should be affirmed because: (1) the decision below is clearly correct as a matter of statutory interpretation and (2) the decision below is clearly correct as a matter of constitutional law even if the court below erred in statutory interpretation in reaching its decision. The arguments of the other Respondents dealing with the correctness of the decision below as a matter of statutory interpretation presented in their briefs are correct and substantially complete and will not be repeated here. The only argument to be presented here is the constitutional argument.

The primary thrust of the constitutional argument is that any and all FPC regulation of independent producers of natural gas with respect to interstate wholesale sales of natural gas, is unconstitutional because:

A. Said application and concomitant regulation, as time and experience have shown, constitutes invidious, capricious discrimination against these producers in violation of the guarantees of equal protection of the law, embodied in the due process clause of the Fifth Amendment to the Constitution of the United States.

B. The above-mentioned FPC regulation has had an adverse effect on the natural gas conservation policies of the states, depriving the states of what this Court in *Champlin Refining Company v. Corporation Commission of Oklahoma*, 286 U.S. 210 (1932) said is an inherent part of the police power — the prevention of above and below ground waste of oil and gas — and thereby violates the Tenth Amendment to the Constitution of the United States.

In addition, judicial removal of any and all FPC regulation of independent producers of natural gas with respect to interstate wholesale sales of natural gas should have no effect on any actions, sales, regulations or operations of such independent producers until after the effective date of said removal.

## ARGUMENT

### I

### THE FPC DOES NOT HAVE ANY JURISDICTION OVER ANY INDEPENDENT PRODUCERS OF NATURAL GAS WITH RESPECT TO INTERSTATE WHOLESALE SALES OF NATURAL GAS BECAUSE ANY AND ALL FPC REGULATION OF INDEPENDENT PRODUCERS WITH RESPECT TO INTERSTATE WHOLESALE SALES OF NATURAL GAS VIOLATES PROVISIONS OF THE FIFTH AND TENTH AMENDMENTS TO THE CONSTITUTION OF THE UNITED STATES.

A. ANY AND ALL FPC REGULATION OF INDEPENDENT PRODUCERS OF NATURAL GAS WITH RESPECT TO INTERSTATE WHOLESALE SALES OF NATURAL GAS CONSTITUTES INVIDIOUS DISCRIMINATION AGAINST THESE PRODUCERS IN VIOLATION OF THE GUARANTEES OF EQUAL PROTECTION OF THE LAW, EMBODIED IN

THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

In light of current and evolving technology and economic developments in the energy industry, any and all FPC regulation of any interstate wholesale sales of natural gas by independent producers constitutes unconstitutional, invidious discrimination. This discrimination is against the independent producer in favor of the gas utility, each being a supplier of natural gas. Said discrimination is also against these same independent producers in favor of producers of energy-yielding commodities other than natural gas, i.e., crude oil, liquid petroleum condensates and gas, coal, and nuclear fuels. Because such discrimination is invidious, FPC regulation of independent natural gas producers is a violation of constitutional guarantees of equal protection of the law, and thereby violates the Fifth Amendment to the Constitution of the United States.

The equal protection of the law guarantees contained in the Fourteenth Amendment to the Constitution of the United States are provided against discriminatory acts of the Federal Government through inclusion of equal protection guarantees within the due process clause of the Fifth Amendment. See *Brown v. Board of Education of Topeka*, 347 U.S. 483 (1954) and 349 U.S. 294 at 298 (1955), which by implication applied equal protection clause provisions to end racially segregated schools in the District of Columbia, which are governed by Federal, not state law. This Court in those cases stated that all provisions of *Federal*, state or local law requiring or permitting racial discrimination in public schools must yield. 349 U.S. 294 at 298 (1955).

The most recent decision of this Court applying constitutional equal protection of the law guarantees (of the Fourteenth Amendment) to invalidate economic regulation was *Morey v. Doud*, 354 U.S. 457 (1957). Forgotson's contention is that any and all FPC regulation of independent producers with respect to their interstate wholesale sales of natural gas violates the equal protection of the law guarantees against discriminatory economic regulation announced in *Morey v. Doud*, supra.

This is in spite of (1) the now substantially undisputed power of Congress to pass nondiscriminatory economic regulatory legislation under the commerce clause of the Constitution, *N.L.R.B. v. Jones and Laughlin Steel Corp.*, 301 U.S. 1 (1937); and *Wickard v. Filburn*, 317 U.S. 111 (1942); and (2) the decisions that such regulation either by the states or the Federal Government does not constitute a deprivation of property without due process of law. *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U.S. 575 (1942); *Nebbia v. New York*, 291 U.S. 502 (1934).

In *Morey v. Doud*, 354 U.S. 457 (1957), a ruling was affirmed, enjoining enforcement of the Illinois Community Currency Exchange Act of 1943, because the act violated the equal protection provisions of the Fourteenth Amendment.

The act in question provided a comprehensive system for licensing and regulation of community for-fee check cashing services and issuers of money orders and made operation of an unlicensed establishment a crime. In order to obtain a license, establishments were required to pay both licensing and investigative fees, furnish information to the Illinois State

Auditor's Office, maintain specified amounts of cash on hand and possess surety bonds in specified amounts. In addition, each exchange had to be financed and conducted as a separate business entity. Finally, a license could not be issued unless the State Auditor determined that its issuance would promote a convenience and advantage to the community. The American Express Company and its money orders were explicitly exempted from the provisions of the act.

The majority of this Court made the following points clear with respect to application of equal protection guarantees to economic regulatory legislation:

(a) The clause permits the exercise of a wide scope of discretion in classification and prohibits only those classifications that are purely arbitrary.

(b) The complainant must carry the burden of showing that the law in question does not rest upon any reasonable basis, but is essentially arbitrary.

(c) Regulatory legislation to be valid cannot single out any company or group of companies and create a closed class with accompanying economic advantages to the closed class. *Morey v. Doud*, 354 U.S.457 (1957).

*Morey v Doud*, supra, has never been overruled by this Court.

The wrong in the legislation invalidated in *Morey v. Doud*, supra, was that the American Express Company was given legal preference, particularly in the business of selling money orders.

The FPC stands on the authority of *Permian Basin Area Rate*

*Cases*, 390 U.S. 747 (1968), for upholding the constitutionality of FPC regulation of independent producers with respect to interstate wholesale sales of natural gas.

This Court in *Permian*, supra, never considered the equal protection question raised herein. In addition, former decisions of this Court sustaining the constitutionality of statutory laws do not preclude bringing subsequent suits to test their validity in light of later actual experience because statutory laws, valid when made, may become arbitrary in operation by reasons of later events. *Abie State Bank v. Bryan*, 282 U.S. 765 (1931).

This Court in *Permian*, supra, relied primarily on the cases, discussed immediately below, to determine the legality of the above-mentioned FPC regulation.

The first of those cases is *Munn v. Illinois*, 94 U.S. 113 (1876). That case arose upon an information action, filed in the Criminal Court of Cook County, Illinois, against public warehousemen for operating without a license. Mr. Chief Justice Waite dealt with the issues in the following way:

> " 'There is no doubt that the general principle is favored, both in law and justice, that every man may fix what price he pleases upon his own properties or the use of it; but if for a particular purpose the public have a right to resort to his premises and make use of them, and he have a *monopoly in them for that purpose, if he will take the benefit of that monopoly, he must, as an equivalent, for his monopoly perform the duty attached to it on reasonable terms.*
>
> " ' * * * [w]henever the accident of time casts upon a party the benefit of a legal monopoly of landing goods * * * he is confined to take the reasonable compensation

only * * *'" Munn v. Illinois, 94 U.S. 113 at 127 (emphasis added)

Two other key decisions relied upon also turn on the necessity for rate regulation when applied to monopolistic situations. *Tagg Bros. and Moorhead v. United States,* 280 U.S. 420 (1924) involved monopolistic practices and price fixing by brokers at the Omaha, Nebraska stockyards.

The *New England Division Case (Akron, C & Y Ry. Co. v. United States),* 261 U.S. 184 (1923), involved a means of distributing already regulated revenues from railroads, each of which at that time had a monopoly or a controlled oligopoly of a service covering a given territory or region. The Interstate Commerce Commission under the Transportation Act of 1920, 15 U.S.C. § 418 was simply allowed to try to assure an equitable division of profits in a clearly regulated, monopolistic or oligopolistic industry. See also *Covington and L. Turnpike Road Co. v. Sandford,* 164 U.S. 578 (1896) (a turnpike-transportation monopoly subject to rate regulation); *Acker v. United States,* 298 U.S. 426 (1936) (Chicago Stockyards — substantially similar to *Tagg Bros.,* supra.)

Another decision used to support rate regulation of the type carried out by the FPC is *Hegeman Farms Corporation v. Baldwin,* 293 U.S. 163 (1934). That decision really involved minimum prices or floors on a perishable and unique product, milk, and gave no consideration to the possible discriminatory effect of maximum prices.

The last major precedent relied on is *Bowles v. Willingham,* 321 U.S. 503 (1944). In that decision, the rent control provisions of the Emergency Price Control Act of 1942

(passed during the emergency of World War II), 50 U.S.C.A., Appendix 902, were challenged. This Court's decision rested on a point unrelated to the constitutional issues raised herein, namely that a nation which can demand the lives of its men and women during the waging of a great war is under no constitutional mandate to provide a system of price controls on the domestic front which will assure to each landlord a fair return on his property.

The discussion above clearly shows that this Court in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) did not consider the discrimination issue raised by Forgotson herein, but instead looked at the above mentioned FPC regulation, as an abstract proposition and concluded that it was supportable because non discriminatory rate regulation is permissible to deal with war emergencies or monopolistic situations or, where minimum rates are involved, to protect public health. It is Forgotson's contention that the above mentioned FPC regulation is discriminatory and cannot be justified in January, 1974, by the precedents used by this Court in *Permian, supra*.

It is Forgotson's contention that FPC regulation of independent producers of natural gas with respect to interstate wholesale sales of natural gas creates two closed or economically favored classes of energy suppliers which classes are given accompanying economic advantages, namely (1) gas utilities which can buy a premium fuel at non-competitive prices and (2) producers of all other energy-yielding commodities such as crude oil, coal and nuclear fuels who are, except in emergencies, subject only to state conservation laws and the market mechanism for determination of their prices. For this

reason said application is arbitrary, capricious and constitutes invidious discrimination unless it can be justified otherwise.

This Court in many previous cases has classified parties to natural gas regulatory litigation, involving independent producers with respect to interstate wholesale sales of natural gas, as producers, consumers and the FPC.

It has classified independent producers as producers, has equated gas utilities with consumers and has classified the FPC as the FPC. A better classification would be: Suppliers, which includes producers, interstate gas pipeline transmission companies and gas utilities; Regulators, which balance the interests of consumers and suppliers in the interests of social and economic justice (which includes the FPC and state public utility or service commissions and which *should* include the conservation commissions of the states); and Consumers, e.g., housewives or industrial enterprises using natural gas as a fuel.

It is Forgotson's contention in the case of gas utilities that equating them and their interests with the consumer and the consumer interest has resulted in placing a discriminatory burden on another member of the *Supplier* group, the independent producer, and given a preference to the gas utility, another member of that *same group* on the erroneous grounds that this is protecting the consumer interest.

The consumer interest is really different from the *interest* of the gas utility and it is the gas utility, not the consumer, that receives the direct benefits that accrue from overall FPC regulation of said independent producers, e.g., on August 10,

1971, the FPC ruled that a natural gas pipeline company must pass any refunds from its suppliers (primarily independent producers) on to its gas utility customers, even if there were no assurance that such refunds would reach the ultimate consumer. The Commission held that the money must be passed on to the gas utility, "leaving it to the state and local authorities to order further flow through." See *The Wall Street Journal*, p. 6, Col. 3, dated Wednesday, August 11, 1971.

Any and all FPC regulation of independent producers of natural gas with respect to interstate wholesale sales of natural gas results in the independent producers being regulated in a manner quite similar to gas utilities when in fact such regulation is inappropriate for said independent producers. This has resulted in placing the gas utilities in the position of an economically favored closed class.

What is being done to independent natural gas producers by FPC regulation of their interstate wholesale sales of natural gas goes beyond mere lack of wisdom, providence and harmony with a particular school of thought. *Williamson v. Lee Optical Co. of Oklahoma*, 348 U.S. 483 (1955). It constitutes regulation which in light of current conditions is arbitrary, invidious and discriminatory. It has created a closed-class of entrepreneurs within the Supplier group, the gas utilities, which are subject to risks in no way comparable to those of the independent natural gas producer. The gas utilities earn a guaranteed rate of return for their security holders and have a competitive advantage against other energy suppliers, because of their being able to buy their raw material at a controlled maximum price, free from market forces.

To meet the test of equal protection, all members of the group should be treated alike to the greatest extent possible. The test does not require either comprehensiveness of regulation or absolute mathematical equality of treatment. Neither does it require dealing with all facets of the problem at the same time, but allows legislative discretion to attack some evils before attacking others. Nevertheless, equal protection should not *permit* one member of a group to be regulated in order to advance the economic interests of another group or groups in the same class *without clear justification*. In the current situation interests of the gas utility members of the Supplier group are advanced at the ultimate expense of the independent natural gas producer.

It might be argued that the overall FPC regulation of the interstate natural gas sales of independent producers which results in their being treated like a gas utility is appropriate and places no discriminatory burden on said independent producers because both independent natural gas producers and gas utilities are public utilities. This Court dealt with that contention in 1968 when it stated:

> "Producers of natural gas cannot usefully be classed as public utilities. They enjoy no franchises or guaranteed areas of service. They are intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded search." *Permian Basin Area Rate Cases*, 390 U.S. 747 at 756-757 (1968).

A major issue then is whether the result of FPC regulation of independent producers of natural gas with respect to interstate wholesale sales of natural gas must always be public

utility treatment which is inappropriate and constitutes invidious unconstitutional discrimination.

Forgotson's contention is that the answer to this question is yes for the reasons set out below.

It might be argued that independent producers of natural gas are not treated like public utilities by the FPC with respect to interstate wholesale sales of natural gas because the FPC need abide by no fixed formula and can pragmatically adapt policies and procedures to meet changing conditions. Forgotson's contention is that as a practical matter, there is and can only be public utility treatment of said sales by said independent producers, because that is all that a regulatory agency like the FPC can do. It can develop formulas *ad infinitum*, but they all have been and *perforce* will be based on allowing some "fair" rate of return on capital expenditures and operating costs with or without added artificial incentives to stimulate hoped for exploration and development of additional gas reserves.

The FPC's actual performance substantiates this conclusion.

In the major independent producer gas rate cases, the central controversies have involved what should be allowed as capital costs, what are operating costs, what should be allowed as a fair return on an investment (including such questions as whether expenditures for dry holes or gas of less than pipeline quality constitute capital costs or expenses), should incentives for exploration be allowed, and if so, how much? These are all classical public utility regulatory questions. See e.g., *Austral v. Federal Power Commission*, 428 F. 2d 407

(5th Cir., 1970); *cert. denied, sub nom. Associated Gas Distributors v. Austral,* 400 U.S. 950 (1970).

Consequently the above mentioned FPC regulation constitutes inappropriate public utility treatment of said independent producers and unconstitutional discrimination by advancing the economic interest of another member of the supplier group, the gas utilities, unless some clear-cut justification for it exists.

In addition, there is another closed class created by the above mentioned FPC regulation, the producers of other energy-yielding commodities such as crude oil, coal, liquid petroleum condensates and gas, and nuclear fuels, who are not treated like public utilities and who are regulated primarily, except in emergencies, only by the market mechanism and state conservation laws with respect to the interstate or intrastate wholesale sales of their products.

It should be emphasized that natural gas like crude oil and coal, or for that matter nuclear fuels, is simply an energy-yielding commodity which when consumed yields a given amount of energy per unit of mass or volume consumed. Yet the independent natural gas producer with respect to interstate wholesale sales of natural gas is, among other things, subject to rate regulation and cannot terminate sales to purchasers even after the expiration of said purchaser's sales contract without permission of the FPC. In addition, said producers with respect to said sales are subject to a relatively complex and expensive overall regulatory program to which the producers of the other energy-yielding commodities mentioned herein are not subjected. Consequently, there is further invidious discrimination against said independent natural

gas producers with respect to said sales unless there is some clear-cut justification.

The question then is, is there any clear-cut justification for creation of the two favored closed classes, the gas utilities and the producers of other energy-yielding commodities, thereby permitting FPC regulation of independent natural gas producers with respect to interstate wholesale sales of natural gas and the resulting discrimination? Do the following characteristics of said independent producers, said sales or the product have any special features which will justify the discrimination, mentioned above, resulting from the above mentioned FPC regulation?

### (1) Transmission or Transportation Characteristics of the Product.

In this country because of advances in technology related to transmission of fuels, coal slurries, as well as natural gas, crude oil and liquefied petroleum condensates and gases can be transported by pipelines in interstate commerce, either for use or resale at their remote destination. Coal, crude oil, liquid petroleum condensates and gases, and heavier so-called bottle gases (e.g., butane and propane) can also be sold either at the wellhead, mine shaft, excavation pit, refinery or gas processing plant to pipelines for interstate transmission and subsequent resale or sold directly to customers, not for resale, who then use pipeline facilities to transmit the product or commodity to other locations in distant states for use as energy sources. In addition, natural gas itself can be liquefied and shipped via railroad tank car, truck, barge or ocean-going vessel rather than by a pipeline to interstate or foreign des-

tinations either for resale or direct use, just as other hydrocarbon or fossil fuels or even the nuclear fuel, uranium, can be shipped. Consequently, the product has no special features, referred to above, with respect to transmission or transportation.

**(2) Scarcity of the Product.**

It can be assumed that natural gas is in actual short supply in the United States. So are crude oil, liquid petroleum condensates and gases.

Even nuclear fuel (uranium), still a fuel of the future, is scarce. In discussing the uranium supply problem, President Nixon, on June 4, 1971, stated:

> "A major cause of our recent energy problems has been the sharp increase in demand that began about 1967 * * *. But in the last four years it has been growing at a faster pace and forecasts of energy demand a decade from now have been undergoing significant upward revisions.
>
> * * *
>
> "* * * Because of its highly efficient use of nuclear fuel, the breeder reactor *could* extend the life of our natural uranium fuel supply from *decades* to *centuries* * * *" (emphasis added). "Clean Energy Message from The President of the United States." H.R. Doc. 92-118, 92nd Cong., 1st Sess., pp. 1 and 4 (June 4, 1971).

Consequently, the product has no special features, referred to above, with respect to its scarcity.

**(3) The Ideal Energy-Yielding Commodity Nature of the Product.**

It must be assumed that natural gas is a very excellent energy-

yielding commodity in that it has a high BTU value per unit volume (averaging about 1,000 BTU/cubic foot), and burns without fly ash sulfur oxides, and many products of incomplete combustion such as hydrocarbon radicals and carbon monoxide.

However, nuclear fuels produce no fly ash, sulfur oxide or hydrocarbon combustion air pollution products and have a much higher BTU content per unit consumed (whether by weight or volume). Moreover, both refining and combustion processes are being developed to decrease markedly the pollution problems caused by consumption of crude oil products and work is proceeding on developing "synthetic" gas by hydrogenation of coal. Consequently, natural gas is an excellent energy-yielding commodity, but is not the ideal energy-yielding commodity. It clearly is and has been the preferred commodity because of its artificially low price which has resulted from the discriminatory regulation discussed in this brief. Consequently, the product has no special features, referred to above, with respect to its being the ideal energy-yielding commodity.

(4) **Monopolistic Characteristics of Independent Producers.**

Production and interstate wholesale sale of natural gas by independent natural gas producers as distinguished from interstate pipeline transportation and distribution to ultimate consumers, is not and has not been monopolistic, but competitive. See generally "Utility Corporations, Final Report of the Federal Trade Commission to the Senate of the United States pursuant to Senate Resolution No. 83," 70th Cong., 1st Sess., No. 84-A (1936); see also *Permian Basin Area Rate Cases*, 390 U.S. 747 at 756-757 (1968). The competition is

as great or greater than among producers of other fuels such as coal, crude oil, liquefied petroleum condensates and gas and uranium, in addition to producers in other industries such as automobiles.

In 1970, according to the FPC itself, there were over 4,600 independent producers engaged in interstate sales of natural gas for resale and 70 independent producers controlled a total of approximately 85 percent of the interstate sale for resale market nationwide (with no measurement of the intrastate market which is quite sizeable and has been preferred wherever possible by many independent producers because of FPC regulation of the interstate market). Furthermore, new firms are entering the interstate sale for resale market. In 1962, 10% of this particular market was occupied by firms entering after 1960. *Hodges,* "Natural Gas: Price Regulation v. Supply," unpublished *Richard J. Gonzales Lecture,* April 23, 1970, College of Business Administration, University of Texas.

If production rather than markets is analyzed, the four largest independent producers at the national level controlled 32.1% of production and the eight largest independent producers controlled 37.6% of production as of 1962. By way of contrast, the production concentration for the four largest producers of *all products* in the United States was 40% with many basic products such as automobiles, copper, soap, glass, electric light bulbs, and photography equipment showing of 90% or above among the four largest producers of each product. *Hodges,* supra.

By disaggregating the national market on a regional basis, the top four independent gas producers in 1962 controlled

only 24.7% of the Gulf Coast regional market for interstate sales for resale, and 22.9% of the Mid-Continent-Permian Basin regional market for interstate sales for resale. Furthermore, the big four in the Mid-Continent-Permian Basin area are not necessarily the same as the big four in the Texas-Gulf Coast, Southern Louisiana or Rocky Mountain areas. *Hodges*, supra.

Consequently, said producers have no special features, referred to above, with respect to monopolistic characteristics except for their being highly competitive.

Consequently, any and all FPC regulation of said independent producers with respect to interstate wholesale sales of natural gas creates invidious discrimination which cannot be justified and is more than unwise, improvident or out of harmony with a particular school of thought. *Williamson v. Lee Optical Co. of Oklahoma*, 348 U.S. 483 (1955), *Morey v. Doud*, 354 U.S. 457 (1957).

This is not to say or even imply that the Natural Gas Act is totally unconstitutional or even that its application to control field prices of gas charged by producer-affiliates or subsidiaries of interstate gas transmission companies is unconstitutional. It is FPC regulation of any independent natural gas producers with respect to interstate wholesale sales of natural gas that is unconstitutional.

B. ANY AND ALL FPC REGULATION OF INDEPENDENT PRODUCERS WITH RESPECT TO INTERSTATE WHOLESALE SALES OF NATURAL GAS HAS HAD AN ADVERSE EFFECT ON THE CONSERVATION POLICIES OF THE STATES, DEPRIVING THE STATES OF WHAT THIS COURT IN *Champlin Refining Company v. Corporation*

*Commission of Oklahoma*, 286 U.S. 210 (1932), SAID IS AN INHERENT PART OF THE POLICE POWER — THE PREVENTION OF ABOVE AND BELOW GROUND WASTE OF OIL AND GAS — AND THEREBY VIOLATES THE TENTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

This argument is well summed up in an article by the late Ernest O. Thompson. Thompson, "The Texas Market Demand Statute on Oil and Gas and its Application," 39 Tex. L. Rev. 139 (1960). In that article, Thompson, who was at the time the Chairman of the Texas Railroad Commission, in describing the Texas oil and gas conservation policy which remains effective today, referred to statutes and court decisions which enunciate said policy and concluded that said policy is based on prevention of underground and above ground waste, including economic waste.

The real issue for this Court is: Does the above mentioned FPC regulation negate this state policy by causing waste, because artificially low prices caused by said application and regulation might dictate either premature abandonment of wells or failure to complete wells, both of which can result in permanent "flooding out or drowning" of geological formations capable of producing gas and/or associated oil and permanent loss of recoverable oil and gas in place?

In light of the high cost of regulation, even if a special exception is allowed by the FPC with respect to gas prices from certain wells to prevent waste, such an exception frequently will not be sought, and FPC-dictated artificially low gas prices with respect to said sales by said producers can cause otherwise premature abandonment or failure to complete in spite

of an adequate market demand and adequate pipeline capacity to transport the gas to willing and needy buyers.

Although there are no real precedents dealing with the scope or weight of the Tenth Amendment to the Constitution of the United States in a situation such as this, a collision between Federal authority and the legitimate exercise of the states' police power has occurred which in this case should be resolved in favor of the states' police power because without the conservation program of the states working properly, there will be no supply of natural gas to be sold to consumers at just and reasonable prices or at any price.

See Note, "Conservation of Natural Gas and the Federal-State Conflict," 64 *Colum. L. Rev.* 888 (1964).

## II

## JUDICIAL REMOVAL OF ANY AND ALL FPC REGULATION OF INDEPENDENT PRODUCERS WITH RESPECT TO INTERSTATE WHOLESALE SALES OF NATURAL GAS SHOULD HAVE NO EFFECT ON ANY ACTIONS, SALES, REGULATIONS OR OPERATIONS OF SUCH INDEPENDENT PRODUCERS UNTIL AFTER THE EFFECTIVE DATE OF SAID REMOVAL.

This point is well supported by the jurisprudence of this Court. In *Chicot County Drainage District v. Baxter State Bank*, 308 U.S. 371 (1940), this Court held that a later holding of unconstitutionality of a Federal Statute would not operate retroactively so as to render previous judgments under

the law later determined to be unconstitutional, null and void. That decision is still good law today.

## CONCLUSION

For the above reasons, Respondent Forgotson respectfully prays that the judgment of the Court below be affirmed.

Respectfully submitted,

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## PROOF OF SERVICE

The undersigned, a member of the Bar of this Court, hereby certifies that a copy of the foregoing Brief has this the ........ day of January, 1974 been served upon each counsel of record for respondents in accordance with Rule 33 of this Court, by depositing the same in a United States mail box, with first class postage prepaid, addressed to said counsel at their post office addresses.

Edward H. Forgotson

# ADDENDUM A

## CONSTITUTION

### AMENDMENT V — CAPITAL CRIMES; DOUBLE JEOPARDY; SELF-INCRIMINATION; DUE PROCESS; JUST COMPENSATION FOR PROPERTY

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

### AMENDMENT X — RESERVED POWERS TO STATES

The powers not delegated to the United States by the Constitution nor prohibited by it to the States, are reserved to the States respectively, or to the people.

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## CASES CITED

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

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No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner*

v.

TEXACO INC., ET AL.

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No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., Co-Executors of the Estate of Mrs. James R. Dougherty, Et Al., *Petitioners*

v.

TEXACO INC., ET AL.

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**On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## BRIEF FOR TENNESSEE GAS PIPELINE COMPANY, A DIVISION OF TENNECO INC.

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### OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. pp. 1a-22a) [1] is reported at 474 F.2d 416. The initial order (No. 428) of the Federal Power Commission (Pet. App. pp. 29a-46a), its order (No. 428-A) of amend-

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[1] "Pet. App." refers to the appendices to the petition in No. 72-1490.

ment (Pet. App. pp. 47a-49a), and its order (No. 428-B) denying rehearing (Pet. App. pp. 50a-84a) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

## JURISDICTION

The judgment of the Court of Appeals was entered on December 12, 1972 (Pet. App. pp. 23a-25a). Petitioners' petitions for rehearing were denied on February 5, 1973 (Pet. App. pp. 26a-28a). The petitions for a writ of certiorari were filed on May 3, 1973 and were granted on October 9, 1973 (J.A. 254).[2] The jurisdiction of this Court rests upon 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTION PRESENTED

Whether the Natural Gas Act vests authority in the Federal Power Commission to exempt small producers from the just and reasonable rate requirements provided in Sections 4 and 5 of the Act and to attempt to close the resulting regulatory gap indirectly through review of the prices charged by such small producers as costs to the pipeline purchasers in proceedings involving the rates of such pipelines.[3]

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[2] "J.A." refers to the separate appendix printed for the proceeding before this Court.

[3] In its formulation of the Question Presented, the Commission seeks to leave the impression that its actions here involved were principally procedural in nature by stating the question in terms of an exemption from "certain [undescribed] filing requirements under the Natural Gas Act * * *" (Comm. Br. p. 2). There is no question, however, that the Commission actions are substantive and undertake to relieve the small producers *per se* from direct rate regulation under the Act (See Comm. Br. pp. 7, 27).

## STATUTE INVOLVED

The pertinent provisions of Sections 1(b), 4, 5 and 16 of the Natural Gas Act, 15 U.S.C. 717(b), 717c, 717d, and 717o are set forth in the Appendix, *infra*, pp. 1a-3a.

## STATEMENT OF FACTS

By Notice of Proposed Rulemaking issued July 23, 1970, the Federal Power Commission proposed "prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers", *i.e.* producers whose total jurisdictional sales do not exceed ten million Mcf of natural gas annually (J.A. 1-13). Following the submission of written comments by various affected producers, pipelines,[4] distributors and State Commissions (J.A. 97-134) and the holding of an informal conference (J.A. 135-154), the Commission promulgated its Order No. 428 here involved (J.A. 135-154).

By this Order which is captioned "Exemption of Small Producers from Regulation" (J.A. 135), the Commission provided for the issuance of blanket certificates to small producers under which they would thereafter be exempt generally from the rate, certificate and certain filing requirements provided in the Natural Gas Act and the Commission's regulations thereunder (J.A. 147-149).[5] Under such certificates

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[4] Respondent, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. (Tennessee) filed comments as an affected pipeline company.

[5] Except for the filing of an abbreviated annual report setting forth their total annual volume of jurisdictional sales (J. A. 143-144, 151), and for compliance with the abandonment provisions of Section 7(b) of the Act (J. A. 144, 149).

small producers would *inter alia* be "authorized to make small producer sales nationwide pursuant to existing and future contracts *at the price specified in each such contract*" (J.A. 149).[6] In addition, they would be relieved of the obligation to make refunds with regard to any excessive rates (J.A. 142, 143).[7]

In its Order, the Commission observed that the Natural Gas Act did not require it to regulate all jurisdictional sales of natural gas and left room for the exercise of administrative judgment and discretion such as were involved in its proposed small producer exemption (J.A. 136). Further, it asserted that exempting small producers from the Act's requirements constituted an important step in its discharge of its responsibilities of assuring an adequate gas supply for the interstate markets (J.A. 137).

> "Our purpose in taking action here is not to increase contract prices, but to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce. We seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters. Our action should also ease the administra-

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[6] Emphasis supplied throughout unless otherwise indicated.

[7] In addition to small producer rates no longer being limited by the area rates generally applicable to jurisdictional sales of gas, the Commission ruled that although it had previously held certain types of escalation clauses to be inoperative as contrary to the public interest, it would permit such clauses to operate to permit small producer rates to increase *up to* the applicable area or guideline rates (J.A. 138).

tive burdens connected with processing small producer filings."

The proposed exemption for the small producers, the Commission went on, "does not constitute deregulation of sales by small producers. We will continue to regulate such sales but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with regard to small producer sales" (J.A. 138). Adoption of such indirect regulation, the Commission claimed, came within its "ample authority to inquire * * * into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent." (J.A. 139).[8]

Thus, as a substitute for its direct regulation of the rates for small producer sales to pipelines and large producers, the Commission proposed that resales of such gas by the pipelines and large producers

> "* * * be subject to reduction and refund, with respect * * * to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large

[8] The indirect regulation thus proposed in Order No. 428 apparently constitutes the basis for the assertion in the Commission's Brief( at p. 6):

> "In that order [Order No. 428] the Commission did not exempt small producer sales from all regulation, but rather adopted a form of regulation which it deemed appropriate in the circumstances."

In this connection, it should be noted that the provision for such indirect regulation was added in Order No. 428 without the required notice in the Notice for Proposed Rulemaking in violation of Section 4(a) of the Administrative Procedure Act, 5 U.S.C. 553(b). The Court of Appeals did not reach this question in light of the broad grounds for its invalidation of Order No. 428.

> producers or the prevailing market price for intrastate sales in the same producing area. Tracking increases to the extent they reflect small producer prices for new sales above the standard set forth above may be suspended, and if so, will be collected subject to reduction and refund. The issue will be resolved either in (1) a pipeline rate case or (2) a proceeding involving only the tracking increase.[9] Pipelines must state the grounds for claiming that the rate at which gas is purchased from a small producer is required by the present or future public convenience and necessity. * * * In this manner the market mechanism in the light of regulation of pipeline rates will be protective of consumer interests." (J.A. 142) [10]

On appeal by several affected large producers and pipelines, including Tennessee, the Court of Appeals held that Congress had made the statutory just and reasonable rate standard applicable to all wholesale sales of natural gas in interstate commerce, and had not vested any authority in the Commission to exempt any such sales from direct Commission regulation (Pet. App. 7a-10a). Further, the Court below pointed out that the so-called indirect control of small producer prices through regulation of the costs of large pro-

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[9] Purchasers from small producers were permitted to file tracking increases

> "only if the small producer rate increases, or such increases together with other increases authorized for tracking by applicable Commission rules or orders, affect the pipeline's average cost of purchased gas by one mill or more." (J.A. 143)

[10] By Order No. 428-A the Commission prescribed the form of annual statement to be filed. See J. A. 159-161. By Order No. 428-B, the Commission denied the applications for rehearing filed, *inter alia*, by Tennessee and reaffirmed its basic rulings in Order No. 428 after eliminating some of the retroactivity contained in that Order (J. A. 238-253).

ducers and pipelines was not a complete substitute since the purchased gas costs to be passed on by such purchasers were to be measured not by the statutory just and reasonable standard but by whether the prices paid by these purchasers were

> "unreasonably high, considering appropriate comparisons with ***highest contract prices*** for sales by large producers ***or*** the prevailing market price for ***intrastate*** sales in the same producing areas" (Pet. App. 11a). (Emphasis in original)

Continuing, the Court below noted (Pet. App. 12a-13a):

> "* * * At best, the indirect controls [the Commission] has proposed will insure that the small producer rates which are passed on to consumers are below levels set by private contracting parties (or potentially by state regulation which is not necessarily tied to the federal standard). Nothing at all insures that those levels will be 'just' or 'reasonable'. That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing."

With regard to the argument that "while the Commission would no longer be regulating rates, the *market mechanism* itself would in effect dictate small producer prices which were just and reasonable" (Pet. App. p. 13a) (Emphasis in original), the Court below ruled (Pet. App. p. 14a):

> "* * * such a post hoc rationalization does not coincide with the Commission's own view of its

> Order. The FPC flatly concedes that '[t]he Commission's order does not purport to determine the just and reasonable rates for sales by small producers.' (footnote omitted) To the contrary, the Commission's basic contention all along has been that the 'just and reasonable' standard was not mandatory and that the FPC can simply choose not to regulate rates. (footnote omitted) It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards. Since the Commission itself has not been confident enough to conclude that the market will necessarily yield rates that comply with the statute, this court can hardly uphold the Orders on that ground."

Further accepting the validity of "the Commission's motives [and] its opinion that some form of deregulation of small producers might benefit the consumers of natural gas" (Pet. App. 5a), the Court of Appeals pointed to the recent cases in which it had approved various Commission experiments designed to alleviate the gas shortage (Pet. App. 7a).[11] However, it held that it could not approve the Commission action here since that action went beyond the limits on the Commission's authority (Pet. App. 7a). In this regard, the Court below further commented (Pet. App. 16a):

> "* * * we cannot hold that *non*regulation is the statutory equivalent of regulation. Only Congress can knowingly prescribe nonregulation for small

[11] *Public Service Commission* v. *F.P.C.*, 467 F.2d 361 (D. C. Cir. 1972); *Public Service Commission* v. *F.P.C.*, — F.2d — (Nos. 71-1197 *et al.*, decided May 16, 1972).

> producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* to be mandatory under the Natural Gas Act for all producers." (Emphasis in original).[12]

In his dissent, Judge Fahy agreed that "all rates and charges of any natural-gas company * * * which includes the small producers * * * shall be just and reasonable and if not, that they are unlawful." (Pet. App. 18a). Further observing that the Commission had authority to classify small producers separately (Pet. App. 19a), he took the position that

> "the Commission had [not] abdicated its responsibility to insure that rates of small producers will be just and reasonable. It does not appear from the record before us that any such price that might be charged is reasonably unjust or unreasonable. * * * Moreover, consumer protection is promised and I cannot now hold that the promise will not be fulfilled" (Pet. App. 21a).

Accordingly, while he would have affirmed Order No. 428 generally on the theory that it would not "lead inevitably to unjust or unreasonable rates charged by small producers" (Pet. App. 19a), he nevertheless

> "* * * would strike its provisions prohibiting refunds to pipelines and large producers, leaving

[12] In so holding, the Court also noted (Pet. App. 16a):

> "All of this is not to say that a proper regulatory determination, within the letter and spirit of the Natural Gas Act, could not set a just and reasonable rate for small producers higher than that for large producers. Given the special problems and practices of small producers, such a result is certainly conceivable. But the small producers cannot be exempted from the regulatory scheme, and have their prices tied to the free market, by administrative agency fiat."

open to the Commission to exercise such authority as it has to protect large producers and pipelines in the event the Commission finds they have been charged unreasonably high prices by small producers. * * * Should such a modification temper to a degree the charges of small producers, I think that result must be accepted as required by the public interest represented by the Act. I do not think such possible tempering would go so far as to defeat the purposes of Order No. 428." (Pet. App. 22a).

## INTRODUCTION AND SUMMARY OF ARGUMENT

Basic to the Commission's position before this Court is the thesis that the Court below misinterpreted the "Commission plan" in connection with small producers. According to the Commission (Br., p. 13), the Court below erred in holding that "Order No. 428 would permit small producers to sell natural gas at rates that may be 'unjust' and 'unreasonable' in violation of Sections 4 and 5 of the Natural Gas Act. * * *" To the contrary, the Commission now claims that "it [did] not abandon the 'just and reasonable standards of Sections 4 and 5; rather it establishes an innovative method of indirect regulation which assures that * * * small producers' rates meet the statutory standard * * *." (Comm. Br., p. 13).

This Commission position suffers from a basic fallacy, which permeates its entire brief, stemming from an improper amalgamation of the two entirely separate and distinct facets of the transaction which together make up the sale of gas. One is the sale of gas by the small producer, and the other is the purchase of that gas by the pipeline with the Natural Gas Act imposing direct rate regulation on the sale facet of the transaction. Viewed in light of this dichotomy, it is apparent, as we show in Part I below, that since Order

No. 428 operates to permit the small producers to charge the contractually-permitted prices whatever they may be and without reference to the Act's just and reasonable rate standard, permitting these producers to receive and retain such unregulated prices clearly serves, contrary to the Commission's argument, to abandon the direct Commission rate regulation prescribed by the Act with respect to such producer sales. As the Court below held, such "nonregulation" by the Commission violates the Congressional mandate embodied in the Act.

The Commission deemphasizes and indeed borders on denying that Order No. 428 has such an effect. Instead, it prefers to focus upon the so-called "indirect regulation" provided therein under which small producers rates allegedly are regulated on the purchaser facet of the transaction, *i.e.*, as costs paid by the purchasing pipeline. Part II deals with this aspect of Order No. 428, and shows that, notwithstanding the protestations in the Commission's brief, Order No. 428's "unreasonably high" standard for such costs is not the same or the equivalent of the statutory just and reasonable rate standard. Indeed, making the two standards as the same or full equivalents would frustrate the purpose of Order No. 428. It is only by allowing the two standards to be different would there be any basis for providing the alleged incentive to the small producers to expand their exploration and development activities.

As a result, as Part II further shows, Order No. 428's substitute regulatory scheme not only imposes an unwarranted and illegal regulatory burden upon such pipelines, but it does so under standards which, in addition to departing dramatically from the Act's just

and reasonable rate standard, reopens a regulatory gap of the type which Congress and this Court thought had been closed by the Natural Gas Act. Moreover, such shifting of the responsibility of guarding against excessive prices imposes unwarranted burdens upon the pipelines which are accentuated by Order No. 428's standards which are impermissably vague and fail to provide the pipelines with the guidelines necessary to enable them to ascertain, when they contract to purchase small producer gas, the "reasonableness" *vel non* of the prices they are agreeing to pay.

Finally, we show in Part III that the reasons advanced by the Commission in purported justification for Order No. 428 are unsound, invalid and unsupported by the record. While Tennessee is, of course, fully aware of the critical shortage of natural gas and entirely sympathetic with the Commission's efforts to alleviate that shortage, exempting small producers from direct rate regulation will not provide the stimulus urged by the Commission. Moreover, whatever benefits do result from such exemption will be far outweighed by the increased costs to the pipelines and the ultimate consumers.

## ARGUMENT

## I.

### THE COMMISSION HAS EXCEEDED ITS AUTHORITY IN EXEMPTING SMALL PRODUCER SALES FROM THE DIRECT RATE REGULATION PRESCRIBED BY THE NATURAL GAS ACT

#### A. Order No. 428 Exempts Small Producer Sales from Direct Rate Regulation Under the Act

##### 1. Order No. 428 Discards the Statutory Standard in Favor of Contract Negotiated Prices

Contrary to the Commission's present claim (*e.g.* Br. p. 13), there can be no question that both the intent and end result of Order No. 428 are to exempt the

rates charged by small producers for their sales of natural gas from compliance with the Act's just and reasonable rate standard. Order No. 428 provides—to quote the Commission (Br. p. 14)—for the issuance to small producers of "blanket certificates authorizing them to sell gas *at whatever contract rates they are able to negotiate.*" Specifically, as pointed out, *supra*, p. 4, the language of Order No. 428 is to the effect that upon receiving a blanket certificate from the Commission, small producers shall "be authorized to make small producer sales nationally *pursuant to existing and future contracts at the price specified in each such contract*" (J.A. 149).

In addition, as the Commission further recognizes Br. p. 27), Order No. 428 "also eliminates for the small producer the risk that they will be ordered to refund any collected rates that are later determined to be unreasonably high". Specifically, the language of Order No. 428 is to the effect that "[s]mall producers will have no refund obligations with respect to increased rates, if any, collected for sales regulated hereunder * * *" (J.A. 142; see also J.A. 143).

These exemptions, Order No. 428 goes on to state, are provided in order "to assure the small producer that when he enters into a new contract for the interstate sales of gas, the provisions of his contract will not be subject to change" (J.A. 137).[13]

Thus, under Order No. 428, the small producers were to have the right to charge and keep the contractually-negotiated prices without regard to the applicable area

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[13] This assurance that their prices would not be subject to change, which Order No. 428 was thus intended to provide the small producers, is at odds with assertions in the Commission's brief (*e.g.*, pp. 11, 25), that it intended in Order No. 428 to retain authority to reduce small producer rates prospectively.

or guideline prices prescribed by the Commission as just and reasonable for producer sales generally.[14] As the Commission further recognizes (Br. p. 27), its "plan" was to operate to "excuse small producers from the price restraints imposed upon large producers by the maximum area rate level." In other words, under Order No. 428 the prices charged and retained by small producers are governed not by the applicable "just and reasonable" ceiling prices, but rather by the price provided in the sales contracts with their purchasers.

Such Commission intention is also demonstrated by the inclusion of the so-called indirect regulatory scheme in Order No. 428. Prior to effectiveness of Order No. 428—when it was clear that the just and reasonable rate standard applied to sales by small producers—the Commission had no problem about permitting the pipelines to recover their full payments to such producers as part of their cost of service without further review. If, as the Commission now claims, rates charged by small producers were to remain subject to the Act's just and reasonable rate standard under Order No. 428, there would be no reason for including the so-called indirect regulatory scheme in Order No. 428. As noted by the Court below (Pet. App. 14a):

> "* * * It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards."

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[14] In contrast to pipelines, which have traditionally been regulated on an individual company cost-of-service basis, the Commission has been regulating rates for producer sales of gas on the basis of area or guideline rates. See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

That Order No. 428 was intended to free the rates charged by small producers from the Act's just and reasonable rate standard is further indicated by the fact that freedom from these restraints obviously constituted the "carrot" which the Commission was holding out to the small producers in order to provide them with an additional incentive to explore for and develop new gas reserves. Small producers in many areas have already been freed from compliance with most of the Act's other requirements *including the need to obtain Commission permission before raising their prices up to the applicable just and reasonable area rate.* Order No. 308, 34 FPC 1202 (1965); Section 157.40 of the Commission Rules and Regulations under the Natural Gas Act; *Cf. Permian Basin Area Rate Cases, supra* at 784-787, see *infra* p. 23.

**2. Order No. 428 Contains No Finding or Basis for Finding that Contract Prices Comply with the Statutory Standard**

Not only does Order No. 428 not provide any ceiling upon the level of the contractually-negotiated prices which small producers would be permitted to charge and retain under Order No. 428, but it does not undertake to make any finding that such contractual prices would comply with the statutory "just and reasonable" rate standard. Nor could any such finding be validly made since Order No. 428 was issued without evidentiary hearing or record.

The rationale underlying Order No. 428 is that the statutory standard is inapplicable since the Commission has exercised its discretion to waive compliance —not that the various prices at which the small producers have now and will in the future contract to sell their gas comply with that standard. Since there is no inherent correlation, much less identity, between contractually-permissible prices and regulated just and

reasonable rates (*cf. F.P.C.* v. *Hope Natural Gas Co., supra* at 601), the Commission's *a priori* advance and sweeping acceptance of contractually negotiated prices as the prices which small producers would be permitted to charge and retain could not be based on an application of the statutory just and reasonable rate standard.

Indeed, it would have been impractical for the Commission even to attempt to make any such finding. Not only will the contract prices being sanctioned in Order No. 428 vary all over the lot but the statutory standard obviously assumes a determination based on a consideration of the surrounding circumstances in each instance and not a general *a priori* and *in vacuo* determination. *Cf.* Section 19(b) of the Natural Gas Act, 15 U.S.C. 717(b).

### B. The Natural Gas Act Does Not Vest the Commission with Authority To Exempt Small Producers Generally from Direct Rate Regulation Under the Act

#### 1. The Act's Rate Standard Applies to All Sales Including Those of Small Producers

The Commission's undertaking here to exempt small producers from direct regulation under the just and reasonable rate standard of the Natural Gas Act clearly constitutes effective abandonment by the Commission of the responsibility delegated to it by the Natural Gas Act. There is no question but that small producers are natural gas companies subject to the Commission jurisdiction as defined in Section 1(b) of the Natural Gas Act, *infra*, p. 1a.[15] Likewise, it is clear that the Commission's rate jurisdiction extends without exception to *all* wholesale sales of gas by such companies, and leaves no room for Commission exemption of any sales

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[15] Section 1(c), added in 1954, 68 Stat. 36, 15 U.S.C. 717(c) contains a limited exception not here applicable.

from "the heart of the * * * regulatory system" (*F.P.C.* v. *Hope Natural Gas Co., supra* at 611) contained in the rate standard provided in Sections 4 and 5 of the Act, *infra,* pp. 1a-2a.

Thus, as held by this Court in *Phillips Petroleum Co.* v. *State of Wisconsin,* 347 U.S. 672 (1954), the Natural Gas Act vests in the *Commission* the responsibility and obligation for regulating directly the rates for "*all* wholesales of natural gas" regardless of the classification, producer or pipeline, large or small, of the seller (347 U.S. at 682):

> "* * * The legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during or after transmission by an interstate pipeline company."

In that case, which involved the question of the Commission's jurisdiction over producer sales generally, this Court went on to say (*Id.* at 682-684):

> "There can be no dispute that the overriding congressional purpose was to plug the 'gap' in regulation of natural-gas companies resulting from judicial decisions prohibiting, on federal constitutional grounds, state regulation of many of the interstate commerce aspects of the natural-gas business. [fn. omitted] * * * Thus, we are satisfied that Congress sought to regulate wholesales of natural gas occurring at both ends of the interstate transmission systems."

In line with this all-inclusive jurisdiction over wholesale sales for resale by natural gas companies, the rate provisions of the Natural Gas Act are "flat, and unqualified" and "bristle with 'any'." *Cf. American*

*Trucking Associations* v. *F.C.C.*, 377 F.2d 121, 130 (D.C. Cir., 1966), *cert. denied,* 386 U.S. 943 (1967). Thus, Section 4(a) prescribes in pertinent part:

> "*All* rates and charges made * * * by *any* natural gas company * * * and *all* rules and regulations affecting or pertaining to such rates * * * shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful."

Section 4(b) directs that:

> "*No* natural-gas company shall, with respect to *any* transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant *any* undue preference or advantage to *any* person or subject *any* person to *any* undue prejudice or disadvantage, or (2) maintain *any* unreasonable difference in rates, charges, service, facilities, or in *any* other respect, either as between localities or as between classes of service."

Section 4(c) similarly requires that:

> "Under such rules and regulations as the Commission may prescribe, *every* natural-gas company shall file with the Commission, * * * schedules showing *all* rates and charges for *any* transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting *such* rates and charges, together with *all* contracts which in any manner affect or relate to *such* rates, charges, classifications, and services."

Likewise, Section 4(d) orders:

> "Unless the Commission otherwise orders, *no* change shall be made by *any* natural-gas company in *any* such rate, charge, classification, or service, or in *any* rule, regulations or contract relating thereto, except after thirty days' notice to the Commission and to the public. * * *"

Finally, Section 5(a), the other major rate provision of the Natural Gas Act, charges in like vein:

> "Whenever the Commission, after a hearing * * * shall find that *any* rate, charge, or classification demanded, observed, charged, or collected by *any* natural-gas company in connection with *any* transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that *any* rule, regulation, practice, or contract affecting *such* rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine *the* just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order * * *".

The Commission has long since recognized the unqualified scope of this Congressional mandate. In its Order No. 174-B in which it amended its then newly-issued regulations implementing this Court's 1954 *Phillips* decision that its jurisdiction extended to producers as well as pipelines, the Commission categorically concluded that "[t]he Act does not provide for exemptions from its requirements * * *" and accordingly rejected numerous requests that its producer regulations "be amended to relieve small producers from the requirements of the statute" (13 F.P.C. 1576, 1577 (1954)).

Likewise, the Commission uniformly held, also with uniform court approval, that the requirements of the Natural Gas Act were applicable to all producers, small and large alike. Thus, in *Saturn Oil & Gas Company, Inc.* v. *F.P.C.*, 250 F.2d 61 (10th Cir. 1957), *cert. denied* 355 U.S. 956 (1958), the Court of Appeals ruled (250 F.2d at 67):

> "* * * There is nothing in the Natural Gas Act which makes its applicability depend on the size

> or the integration of the gas operator. The Phillips decision holds that the Act applies to *all* wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations."

See, also, *Deep South Oil Company of Texas* v. *F.P.C.*, 247 F.2d 882, 884, 887 (5th Cir. 1957) (holding sales of natural gas by "a small unintegrated corporation" to be subject to regulation under the Act); *cf. F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205, 216 (1964).

**2. Section 16 Does Not Delegate Authority Direct to the Commission to Exempt Small Producers from Rate Regulation**

In Order No. 428 the Commission claimed to find "room for administrative judgment and discretion", in Section 16 of the Act as well as in this Court's decisions in *Permian Basin Area Rates Cases, supra,* and *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964), authorizing it to waive its admitted direct rate jurisdiction over small producers (J.A. 136). Likewise, in its brief here (at p. 22) the Commission asserts that this Court's decision in *F.P.C.* v. *Louisiana Power & Light Co.,* 406 U.S. 621 (1972) provides it with the "necessary degree of flexibility" to make appropriate adjustments. But neither Section 16 nor any of the cases thus cited by the Commission provide it with the necessary authority or discretion to abandon the direct rate regulation of small producer sales prescribed by the Natural Gas Act.

Section 16, *infra,* pp. 2a-3a, does not vest authority or discretion in the Commission to ignore or even modify the clear mandate of Sections 4 and 5. However broad and sweeping may be the power given to the Commission by that Section to classify and prescribe different

requirements for different classes, it plainly was not intended to delegate to the Commission authority to revise or modify the coverage as explicitly prescribed by Congress in other provisions of the Act. As stated by the Court below with reference to Section 16 (Pet. App. 10a):

> "The Commission can only classify '[f]or the purposes of its rules and regulations.' It can only prescribe rules and regulations 'to carry out the provisions of this chapter.' Section 16 * * * does not give the Commission independent powers. Rather, it provides for implementation of the core sections of the Act, such as Section 4.' "

This Court has not given Section 16 any broader construction in *F.P.C.* v. *Louisiana Power & Light Co., supra.* The Court there first determined that Section 1(b) included authority for the Commission to control curtailments before it invoked Section 16 as a basis for its statement cited by the Commission (Br. p. 22) that the Commission must be free "* * * to make the pragmatic adjustments which may be called for by particular circumstances." 406 U.S. at 642. In this regard it should be noted that the Commission's excerpt from *Louisiana* omits the Court's limiting language, *i.e.,* that such freedom to make pragmatic adjustments exists only "within the ambit of [the Commission] statutory authority." Thus, the Court's holding in *Louisiana* patently is not as broad as now urged by the Commission.[16]

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[16] Significantly, the quotation from *Louisiana* cited by the Commission, was taken by this Court from its earlier decision in *F.P.C.* v. *Natural Gas Pipeline Co. of America,* 315 U.S. 575 (1942), where it was used to describe the ambit of the Commission authority under the just and reasonable rate standard of the Act. See 315 U.S. at 586.

Likewise, while this Court in *Permian Basin Area Rate Cases, supra,* approved the Commission's actions in exempting small producers from certain requirements, such special treatment did not operate to exempt their sales from direct rate regulation under the Act. Instead, the exemption was very limited and extended only to

> "* * * two forms of special relief: first it released small producers from the requirement that quality adjustments be made in price; (fn. omitted) and second, it commenced a rulemaking proceeding intended to relieve them from various filing and reporting obligations. See 34 F.P.C. 434. The Commission asserted that the consequences for consumer prices of the first would be *de minimis;* it expected that the second would measurably reduce the small producers' regulatory expenses." (fn. omitted) (390 U.S. at 786).

Thus, under the special small producer provisions approved in *Permian Basin Area Rate Cases,* the sales by such producers still remained subject to direct regulation under the just and reasonable rate standard provided in Sections 4 and 5 and the small producers themselves had to bear the consequences of rates charged in excess thereof. In other words, as this Court there stated, "the exemptions created by the Commission for [small producers] are *fully consistent with the terms and purposes of its statutory responsibilities."* (390 U.S. at 787).

Finally, the Commission's position is not advanced by *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964) (J.A. 136, Comm. Br., p. 4). To be sure, Mr. Justice Clark there adverted to the Commission's then congested docket and suggested that (376 U.S. at 527):

> "* * * the techniques of the National Labor Relations Board might be studied with a view to de-

> termining whether its exemption practices, see *Guss* v. *Utah Labor Relations Board*, 353 U.S. 1, 3-4 (1957) might be helpful in the solution of the Commission's problems."

However, not only is this suggestion pure dictum, but the statutory scheme under which the NLRB operates is vastly different in this critical respect from the Natural Gas Act. In contrast to the flat, unqualified mandate of the Natural Gas Act, the National Labor Relations Act vests the Board with broad discretion whether or not to exercise the jurisdiction vested in it. See, *e.g.* *Guss* v. *Utah Labor Relations Board*, 353 U.S. 1, 13-14 (1957) (Mr. Justice Burton dissenting). Plainly, therefore, the exemption practice followed by the NLRB in exercise of its statutory discretion does not support the Federal Power Commission's exemption of small producers from rate regulation under the Natural Gas Act in the teeth of the all-inclusive Congressional mandate contained in Sections 4 and 5 of the Act.[17]

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[17] In light of this Court's stress in both *Permian* and *Hunt* as to the need for relief of the Commission's administrative difficulties, it should be noted that contemporaneously with the litigation in *Permian*, the Commission went ahead with the rule-making proceeding referred to this Court in *Permian* (390 U.S. at 786). As a result, and prior to, and independently of, Order No. 428, the Commission issued Order No. 308, 34 F.P.C. 1202 (1965), authorizing small producers, *inter alia*, (1) to make new sales of gas without seeking any additional certificate authorization under Section 7 of the Act, and (2) to increase their rates *up to the applicable area rate* for contractually authorized rate increases without filing notices of rate change under Section 4(d) of the Act. See *supra*, p. 15; *infra*, p. 53. And although this relief initially was limited to small producers in the Permian Basin, it was subsequently extended to include small producers in Southern Louisiana, Hugoton-Anadarko, Appalachian and Illinois Basins. See Section 157.40 of the Commission Rules and Regulations under the Natural Gas Act.

## II.

## THE SUBSTITUTE REGULATORY SCHEME IS UNLAWFUL AND INEFFECTUAL TO DISCHARGE THE COMMISSION'S RESPONSIBILITIES UNDER THE ACT

In support of its position, the Commission urges that the substitute regulatory scheme is an "innovative method of indirect regulation * * * which ensures * * * that small producers' rates meet the statutory standard" (Br. p. 13). In this regard, the Commission further asserts (Br. p. 20) that its substitute regulatory scheme "does not abandon the statutory 'just and reasonable standard' * * * Rather it * * * provides for a determination of the reasonableness of the rates based in part upon field prices and * * * ensures * * * that the ultimate consumer is fully protected against the effects of unreasonably high small producer rates. * * *"

We show below that, contrary to these assertions by the Commission, Order No. 428's standard for reviewing the pipeline payments for small producer gas is not the same as, nor the equivalent of, the Act's just and reasonable rate standard either theoretically or practically. As a result, the substitute regulatory scheme not only creates a gap in the comprehensive regulatory scheme intended by Congress, but it subjects the pipelines to unwarranted and illegal risks and burdens, accentuated by the vagueness and lack of clarity in the applicable standards set out in Order No. 428.[18]

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[18] In contrast to the characterization in the Commission's brief (*e.g.*, Br., p. 12) of its action in Order No. 428 as "experimental," there is nothing in that Order indicating that the actions there taken were in fact intended as experimental in any sense, least of all in the sense that these actions were intended to be of limited duration only. Any such limited time duration would be inconsistent with the customary practice in the industry under which gas sales contracts are usually for periods of 20 years or more. *Cf. United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 322 (1956).

### A. Order No. 428's Standard for Allowance of Pipeline Payments for Small Producer Gas Is Not the Equivalent of the Statutory Just and Reasonable Rate Standard

In urging that the Order No. 428's standard is the equivalent of the statutory just and reasonable standard, the Commission in its brief before this Court has had (1) to edit the language of Order No. 428; (2) to interpret the language in that order in a new and novel manner; (3) to ignore the historical gloss upon the statutory just and reasonable standard; and (4) to ignore the entire intent and purpose of Order No. 428.

#### 1. "Unreasonably High" Is Not the Complete Standard for Allowance of Pipeline Costs Set Out in Order No. 428

The Commission's initial argument in this regard is that the standard provided in Order No. 428 for passing on pipeline payments for gas purchased for small producers is that such costs not be "unreasonably high". Thus, the Commission asserts (Br. pp. 14-15):

> "The pipelines and large producers are permitted under the order to seek rate increases 'tracking' the small producers' rate increases. The tracking increases, like the small producers' rates, may be collected without refund obligation, but only to the extent that the small producers' rates —*i.e.,* the pipeline's purchased gas costs—are not themselves 'unreasonably high' (App. 140, 142) (footnote omitted). A tracking increase which is based on 'unreasonably high' small producer rates may be suspended by the Commission and is subject to reduction and refund (App. 142, 143)."

But these references to "unreasonably high" are not complete—a fact that is plain on the face of Order No. 428. Thus, with reference to large producer rate in-

creases reflecting gas purchases from small producers, Order No. 428 explicitly provides (J.A. 140):

> "* * * These filings shall be accepted, without refund obligation, as long as the price differential is consistent with prevailing price differentials in the area and as long as the small producer prices for new gas are not unreasonably high, *considering appropriate comparisons with highest contract prices for by large producers or the prevailing market price for intrastate sales in the same producing area.*"

And with reference to comparable pipeline rate increases, Order No. 428 similarly provides (J.A. 142):

> "* * * The pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is *unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area.*"

Plainly, a standard excluding costs which are "unreasonably high" is far different from one excluding costs which are "unreasonably high *considering appropriate comparisons with highest contract prices for sales by large producers on the prevailing market price for intrastate sales in the same producing area.*" By limiting its quotation of the standard for allowance of pipeline costs to "unreasonably high", the Commission would create a misleading impression as to the actual standard provided in Order No. 428.

**2. Order No. 428 Contemplates That the Allowance of Pipeline Payments for Small Producer Gas Be Based Solely upon the Two Market Criteria Set Out in That Order**

The Commission further contends (Br. p. 16) that the Court of Appeals erred in "read[ing] the Commission's order as tying the reasonableness determination *exclusively* to the two market factors" set out in Order No. 428 (emphasis in original). According to the Commission Br. p. 17):

> "* * * the order does not imply that the two stated factors are the *only* ones that may be considered. To the contrary, the standard is one of reasonableness, and the order specifies that in applying that standard '[t]he Commission shall consider *all relevant factors*' (App. 142; emphasis added). The two unregulated market price considerations are among those 'relevant factors' that the Commission will take into account. They were separately identified in the order, not because they were intended to have necessarily controlling importance, but because the Commission wished to signal a departure from its traditional practice of subordinating field prices to other factors in fixing area rates."

In addition to the fact just demonstrated, *i.e.,* that Order No. 428's standard is not "one of reasonableness" *per se,* the above Commission contention is at odds with the plain language of Order No. 428 which clearly and unequivocally sets forth the two market criteria as the primary, if not, the exclusive criteria to be applied in passing on pipeline payments for small producer gas. Thus not only does the excerpt from Order No. 428 last reproduced above indicate that a pipeline's liability to disallowance would be limited to that portion of its costs for small producer gas which are "unreasonably high considering appropriate compari-

sons" with the two market factors, but the Order No. 428 goes on immediately to characterize these factors specifically as "the standard set forth above" (J.A. 142):

> "Tracking increases to the extent they reflect small producer prices for new sales *above the standard set forth above* may be suspended * * *."

Plainly, therefore, the standard provided in Order No. 428 for reviewing pipeline costs for small producer gas is not "one of reasonableness" in the abstract or without a frame of reference as the Commission appears to urge,[19] but rather one of not "unreasonably high" vis-a-vis the two market criteria specifically enumerated by the Commission. Hence, while Order No. 428 does go on to state, as the Commission further urges, that "[t]he Commission shall consider all relevant factors" (J.A. 143), this statement does not, the Commission also urges, serve to detract from the importance of the two market criteria. Rather, all it means is that the Commission would consider all "relevant" factors—whatever that means (see, *infra*, pp. 40-41)—in applying these two criteria.[20]

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[19] "Reasonableness" standing alone, obviously has no meaning and requires a concrete set of circumstances or frame of reference before it can have any substance or meaningful context.

[20] In this regard, it should be also noted that the reasons now asserted by the Commission for "separately identifying" the two market criteria in Order No. 428 find no support in the Commission Orders here involved. Rather, they consist of a *post hoc* rationalization by counsel which, under established principles, can not be accepted in support of the validity of Order Nó. 428. *Cf. Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 401, 419 (1971); *Burlington Truck Lines* v. *U.S.*, 371 U.S. 156, 168-169 (1962).

### 3. Utilization of Market Criteria Constitutes Departure from Traditional Just and Reasonable Rate Standard

In any case, whether the standard for allowing pipeline costs for gas purchased from small purchasers is to be based exclusively or only partially upon the two market criteria, utilization of such market criteria in passing on the reasonableness of rates—assuming that they were to be so used—clearly would constitute an abandonment of the just and reasonable standard of the Act, the Commission's claims to the contrary notwithstanding (Br. p. 13). As the Commission appears to admit (Br. pp. 17-18), such market criteria have not in the past, and are not now, utilized in determining the just and reasonable rates for producers generally.

Thus, as this Court noted in *Permian Basin Area Rate Cases, supra,* in affirming the Commission's refusal there to derive "area rate * * * from field or contract prices" (390 U.S. at pp. 792-795):

> "* * * The record before the Commission * * * supports its conclusion that competition cannot be expected to reduce field prices in the Permian Basin to the 'lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.' *Atlantic Rfg. Co.* v. *Public Service Comm'n,* 360 U.S. 378, 388.
>
> "The field price of natural gas produced in the Permian Basin has in recent years steadily and significantly increased (footnote omitted). These increases are in part the products of a relatively inelastic supply and steeply rising demand; but they are also symptomatic of the deficiencies of the market mechanism in the Permian Basin. * * *
>
> * * * * * * * * *
>
> "These market imperfections, operative despite an 'essentially monopsonistic environment,' have accentuated the consequences of inelastic supply

> and sharply rising demand. (footnote omitted) Once an increase has been obtained by the larger producers, the escalation clauses have guaranteed similar increases to others. (footnote omitted). In contrast, consumers have been left without effective protection against steadily rising prices. Their alternative sources of energy are in practice few, and the demand for natural gas, particularly in California, is therefore relatively unresponsive to price increases. (footnote omitted) The consumer is thus obliged to rely upon the Commission to provide 'a complete, permanent and effective bond of protection from excessive rates and charges.' *Atlantic Rfg. Co.* v. *Public Service Comm'n, supra,* at 388."

To be sure, this Court in *Permian* then went on to note that it was not precluding the consideration of field prices for all time and that "the record in subsequent area proceedings may more clearly establish that the market mechanism will adequately protect consumers interests." (390 U.S. at 795.) However, this reservation does not, as the Commission implies (Br. p. 17), help the Commission's position here. Not only was Order No. 428 issued without an evidentiary hearing, and hence there was no record of any substance made, but, as noted *supra,* pp. 15-16, the Commission in Order No. 428 did not purport to determine that the contractually-permissible rates at which a small producers could sell their gas under Order No. 428 would in fact comply with the just and reasonable standard prescribed in Sections 4 and 5.

### 4. Sellers' Market Makes It Unrealistic To Impose Regulatory Responsibility upon Pipelines

Despite the clear discrepancy between statutory standard and those of Order No. 428, the Commission nevertheless persists in urging that the Order No. 428 standards are the "full equivalent of the statutory 'just and reasonable' standard" (Br. p. 16), in that "the ultimate consumer is fully protected against the effects of unreasonably high small producer rates" (Br. p. 18). This argument is based on the claim that the substitute regulatory scheme operates to provide the pipelines with "a strong incentive to negotiate for producer rates that are sufficiently low to permit them to track the rates without refund obligations" (Comm. Br. p. 20, see also Comm. Br. pp. 15, 24).

In addition to the objections to the substitute regulatory scheme discussed elsewhere in this brief, there should be noted in this connection that since the acute shortage of natural gas has created a strong sellers' market, there is sharp competition among potential purchasers for any new gas which might become available. The pipelines are encountering serious problems in their efforts to purchase enough gas to take care of the needs and requirements of their customers. As the Commission itself urges (Br. p. 5), the existing critical shortage of natural gas "has seriously affected the ability of the Nation's major pipelines to meet the demands of their interstate markets. At the current time, 26 curtailment proceedings * * * have been initiated before the Commission." In these circumstances it is unrealistic and unfair to impose upon the purchasing pipelines the additional responsibility of keeping small producer rates from increasing unduly at the risk of having to absorb the costs subsequently determined by the Commission to be excessive.

**5. Full Equivalence between the Statutory Standard and Order No. 428 Would Frustrate the Purpose of That Order**

As noted earlier herein, Order No. 428 is presumably directed at stimulating greater exploration and development activities by small producers with the "carrot" being that they be permitted to charge and retain contractually-permissible prices in excess and without regard to of the applicable just and reasonable area rates. Accordingly, the less the spread between contractually-permissible prices and the applicable just and reasonable rates, the less would be the incentive provided to the small producer and the more such "incentive" might turn out to be inadequate. On the other hand, the greater the spread between the contractually-permissible prices and the just and reasonable rates, the greater the incentive provided to the small producers. One of the fatal flaws of Order No. 428 is that it does not indicate how great a spread is needed in order to provide an "adequate" incentive. Instead, it places no ceiling upon small producer prices and leaves it up to the purchasing pipelines, subject to the risk of disallowance, to determine the level which the Commission will subsequently determine to be appropriate.

If, as the Commission now urges, the Order No. 428 standard is in fact the same as, or a full equivalent to, the Act's statutory just and reasonable standard such equivalence would in large measure frustrate the purpose of Order No. 428. If, under No. 428, the Commission were to disallow all costs incurred by a pipeline in excess of a just and reasonable rate for small producer gas there would be few, if any, pipelines, which would be willing, or could afford, to contract to pay higher prices for such small producer gas. In other words, the price paid by the pipeline to the small

producer will tend to approximate the level which the Commission would sanction as costs to the pipelines, and therefore, full equivalence between the just and reasonable standard and the Order No. 428 standard would result in little, if any, price differential to the small producers.

Indeed, if there were in fact a full equivalence between the Order No. 428 standard and the statutory just and reasonable rate standard, there would be no purpose at all for Order No. 428 and its substitute regulatory scheme. In such circumstances, the Commission would achieve the same result without abandoning direct regulation of small producer rates. The Commission issued Order No. 428 only because it recognized and intended that there be a substantial spread between Order No. 428 standard and the statutory just and reasonable rate standard. Thus, among the flaws inherent in Order No. 428 are (1) that it allows for a spread between the Act's just and reasonable rate standard and the price received by the small producer and (2) that it provides no measure of the magnitude of this spread.

### B. The Commission's Indirect Regulatory Scheme Creates a Gap in the Comprehensive Regulatory Scheme Intended by Congress

In further support of its substitute regulatory scheme, the Commission also contends (Br. p. 21) that "[t]here is nothing in the Act that requires the Commission to regulate producers' rates directly or to employ *any* particular regulatory method." (Emphasis in original.) While the Commission then goes on to cite Section 16 and quote from a number of decisions of this Court (Br. pp. 21-23), all of these decisions relate to the choice of method in connection with direct

regulation of the natural gas companies involved. None of them even suggest that the Commission has any choice but to regulate all producers sales *directly*. See *supra*, pp. 16-20. To the contrary, both the Act and its history belie the Commission's claim.

Thus, by designating the Commission as the agency responsible for the administration of the Natural Gas Act, Congress left no doubt of its intention directly to charge that agency with the responsibility of fixing the level of rates at which natural gas is to be sold for resale in interstate commerce. Moreover, as indicated *supra*, p. 16, Section 1(b) defines the Commission's jurisdiction as extending not only "to the transportation of natural gas in interstate commerce [and] to the sale in interstate commerce of natural gas for resale * * *," but also "to natural-gas companies engaged in such transportation or sale." Furthermore, as also noted *supra*, p. 18, Section 4(a) applies to "all rates and charges *made, demanded, or received by any natural-gas company* for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission * * *," and Section 5(a) is cast in terms of "any rate * * * *demanded* * * *, *charged or collected by any natural-gas company* in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission * * *."

In addition to these express manifestations of a Congressional intent to prescribe direct regulation for all natural gas companies subject to the Act, it is also clear that both Congress and this Court have regarded indirect regulation such as that purportedly provided in Order No. 428 not to be an effective or meaningful substitute for direct regulation, but rather as consti-

tuting a regulatory gap which can be closed only by direct regulation. Thus, had Congress shared the Commission present views that such indirect regulation was in fact an effective alternative to direct regulation, there would have been no occasion to enact the Natural Gas Act or Federal Power Act; there would have been no "gap" disclosed by the *Attleboro* case (*Public Utilities Commission* v. *Attleboro Steam and Electric Co.*, 273 U.S. 83 (1926) since the local regulatory agencies clearly had the authority to disallow the costs reflecting excessive payments made by the local utilities subject to their jurisdiction.

Similarly, had this Court shared these Commission views, there would have been no occasion for it to rule in *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672 (1954) that independent producers were subject to direct regulation under the Natural Gas Act, since the Commission already had the authority to disallow the costs reflecting excessive payments for gas made by the pipeline companies to such producers. Indeed, one of the effects of Order No. 428 is to reopen for small producers the regulatory gap which this Court thought was closed for all producers by its decision in the *Phillips* case.

Patently, therefore, neither Congress nor this Court have regarded the indirect regulation such as that purportedly provided in Order No. 428 as an adequate substitute for direct regulation. To the contrary, in enacting the Natural Gas Act with the Federal Power Commission charged with its administration, Congress intended that all sales which it provided be subject to regulation under the Act be required to meet the standards provided by the Act, and that the Commission be *the* body directly responsible for achieving that

result. The Commission's attempt in Order No. 428 to shift these responsibilities, therefore, is contrary to both the Congressional intent in enacting the Natural Gas Act and this Court's understanding in deciding the *Phillips* case.

### C. The Substitute Regulatory Scheme Imposes Unwarranted Burdens Upon the Pipelines Coupled with Impermissibly Vague Standards

#### 1. Order No. 428 Imposes New Responsibilities and Risks upon the Pipelines

The substitute regulatory scheme violates the Natural Gas Act in still another way. By shifting to the pipelines the responsibility of not paying excessive prices to small producers at the risk of having to absorb any such excess also flaunts the Congressional intent as clearly manifested in the Natural Gas Act.

Under the scheme of direct rate regulation of small producers sales in effect since at least this Court's decision in the *Phillips* case, it was the Commission's responsibility directly to regulate such producer rates and the risks with regard to excessive rates were borne by the producer selling the gas, not by the pipeline purchasers of the gas. This was so even though the price charged the pipeline by the producer was authorized by the producer's contract with the pipeline. As a result, a pipeline purchasing gas from a producer, small or large, had no responsibility with regard to the reasonableness of such producer's rates and incurred no risk from a regulatory point of view, whatever the rate provided in the contract. If such contract rate was found to be excessive, not only was the producer prohibited from thereafter charging that rate, but the pipeline could even receive a refund of the excessive portion of any such rate already paid.

Order No. 428 with its substitute regulatory scheme would subject the pipelines to responsibilities and risks they did not previously have. No longer would they have the security resulting from the fact that small producers were prohibited from charging rates in excess of the applicable area or guideline price. Instead, the pipelines now would have the responsibility of making sure that the prices which they were paying the small producers met the Commission's purported criteria. In other words, under the Commission's proposed substitute regulatory scheme, each pipeline purchasing gas from a small producer would be subject to the new risks that if upon *post facto* "second guessing," the Commission later determined that such payments were excessive, the amount of the excessive payments would be excluded from the pipeline's cost of service for rate making purposes, and hence would have to be absorbed by the company instead of passed on in the company's rates to its customers.[21]

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[21] The impropriety of such shifting of responsibility is accentuated by Order 428's further provision permitting pipelines to file rate increases to track the increased costs for small producer gas only if that increased cost (combined with other increases authorized for tracking by unspecified Commission orders) "affect the pipeline's average cost of purchased gas one mill or more" (J. A. 143). This means, for example, that before Tennessee could "track" the increased costs resulting from the Commission's exemption of small producers, Tennessee will have to absorb all such cost increases until their accumulated total, either alone or together with other increases authorized for tracking, reached approximately $1,200,000 in annual gas purchase costs. The unreasonableness of this requirement is further compounded by the fact that small producer increases would not become effective all at once, but rather in dribs and dabs over a period of time. In the meantime under this limitation, the pipeline would have to absorb the entire increased cost.

**2. Pipeline Risks under Order No. 428 Are Different From, and Broader Than, under the Standards Applicable to the Disallowance of Costs Generally**

The Commission seeks to minimize the impact upon the pipelines of this shift in regulatory responsibilities by urging (Br. pp. 32-33) that the pipelines traditionally have been borne the risk of disallowance of excessive operating costs. But such risk of disallowance relates to materials and service purchased by the company in connection with its operations, the prices for which are generally governed wholly by market factors and are *not* subject to regulation. Moreover, and more important, under the applicable standards the risks of disallowance was very limited and actual disallowance very infrequent. See *e.g. State of Missouri ex rel Southwestern Bell Telephone Co.* v. *Public Service Commission,* 262 U.S. 276, (1923); *West Ohio Gas Co.* v. *Public Utilities Commission,* 294 U.S. 63, 72 (1935).

For example, in the *Southwestern Bell* case, this Court set aside the disallowance of alleged excessive expenses, stating (262 U.S. at 288-289):

> "* * * There is nothing to indicate bad faith. So far as appears, plaintiff in error's board of directors has exercised a proper discretion about this matter requiring business judgment. It must never be forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in States Public Utilities Commission ex rel. Springfield v. Springfield Gas & Electric Co., 291 Ill. 209, 234, 125 N. E. 891, 901:
>
> 'The commission is not the financial manager of the corporation, and it is not empowered to substitute its judgment for that of the directors

of the corporation; nor can it ignore items, charged by the utility as operating expenses, unless there is an abuse of discretion in that regard by the corporate officers.' "

Likewise, in the *West Ohio* case, this Court, in setting aside a comparable disallowance by a state Commission, commented (294 U.S. at 72):

> "Good faith is to be presumed as the part of the managers of a business. [Citations omitted] In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as a measure of a prudent outlay [Citations omitted]."

Order No. 428's criteria for disallowance are patently far different and broader than those applicable to the disallowance of costs generally. Order No. 428 does not provide for recognition of managerial good faith or prudence. Nor does it provide for deference to managerial discretion and judgment. Instead, as is next discussed, it undertakes to prescribe a set of far broader criteria which suffer from the additional and fatal infirmity of being impermissably vague.

**3. Order No. 428's Standards Are Vague and Fail To Provide the Pipelines with the Requisite Guidelines**

As noted earlier, Order No. 428 provides for disallowance of "that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market prices for intrastate sales in the same producing area" (J.A. 142). These "standards" are vague in that they fail to provide the pipeline with the clear guidelines which they need in negotiating the price and other terms of their purchase agreements with small producers.

If, as the Court of Appeals held, the two market criteria are to be controlling, then there is substantial ambiguity—since there are two criteria listed—whether both are to be taken into account in making the determination or only one. The ambiguity in this regard is accentuated by the use of the disjunctive "or." Suppose, for example, that "the highest contract prices for sales by large producers" are found to be different —higher or lower—from "the prevailing market prices for intrastate sales in the same producing area." Is one to be controlling and if so, which one? If neither is controlling and both are to be taken into account, what is the weight to be given each?

Turning now to the "standards" themselves, what is meant by "the highest contract prices for sales by large producers?" Does the phrase "sales by large producers" include intrastate sales as well as interstate sales? Nonjurisdictional direct sales as well as jurisdictional sales for resale? Short term sales as well as long-term sales? Does the phrase "the highest contract prices" include the highest contract prices even if not paid or the highest contract prices actually paid? Does the phrase include more than one highest contract price, and if so, how are they to be used in making the "appropriate comparisons?" Suppose that the highest prices in a producing area turn out to be 26¢ and 30¢ per Mcf. Which price, if either, would be controlling? And how would the "appropriate comparisons" be made in these circumstances?

The second "standard," *i.e.*, "the prevailing market price for intrastate sales in the same producing area," similarly suffers from vagueness. What is meant by "prevailing market price?" Does it mean the current price at which new contracts are being executed or

the prices currently being paid under existing contracts? As to the "market price," which price does it refer to if there are a number of sales at different prices. The highest, the lowest, the median, the average, weighted or unweighted?[22] Finally, what does "same producing area" include, the field from which the gas is produced or an area such as that used by the Commission in determining area prices or something in between?

The ambiguities in this regard would be even greater under the Commission's present reading of Order No. 428, *i.e.,* that the market criteria were only two of the "relevant" factors which the Commission would consider in passing upon a pipeline's costs for small producer gas. This reading gives rise to the additional questions as to what are the additional "relevant" factors, and to what are they to be "relevant"? Relevant to the "market criteria"? Relevant to the small producers' "costs"? Or relevant to the amount of additional gas made available by small producers as a result of Order No. 428? Are such "relevant factors" the means by which the Commission intends to ascertain the "spread" needed to provide the "incentive" sought to be provided by Order No. 428? Finally, there is the question as to the comparative weight to be given to these additional "relevant factors" as against the market factors specifically referred to by the Commission.

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[22] Assuming, of course, that such information would be available to a pipeline at the time is negotiating a gas purchase contract with a small producer.

#### 4. The Commission's Defenses of Order No. 428 Standards Are Without Merit

The Commission contends that the standards are not impermissibly vague because, according to the Commission (Br. p. 33):

> "* * * reasonableness is the statutory standard governing all rate matters under the Natural Gas Act. Companies that are subject to the Commission's jurisdiction can hardly claim unfamiliarity with the standard; the pipelines' rate base has always been limited to reasonable costs."

This argument reflects the Commission's continued confusion of two separate and distinct facets of a sales transaction.[23] On the one hand, there is the sale aspect—"the statutory standard governing all rate matters under the Natural Gas Act" relates to rates charged for sales made by natural gas companies. For pipelines, such rates are determined on a cost-of-service basis, while for producers, area rates are used. On the other hand, there is the purchase aspect—the "reasonable costs" which pipelines have been allowed to recover as part of their "rate base" have usually been determined under the "imprudence" standard of the *Southwestern Bell Telephone* case, *supra.* In other words, contrary to assumption implicit in the above assertion of the Commission, the criterion for determining the validity of rates is very different from that for determining allowable costs even though both may be stated in terms of reasonableness.

But even more important than the fact that the Commission's statement thus confuses two different

[23] Neither these nor the further factors referred to in the Commission Brief (at pp. 33-34) are relied on in the Orders here under review and hence constitute *post hoc* rationalizations which cannot be accepted as support for Order No. 428. See *supra*, p. 28, fn. 20.

standards is the fact that Order No. 428 does not undertake to adopt either of them. As shown *supra*, pp. 32-33, application of the just and reasonable rate standard would frustrate the entire purpose and intent of the Order No. 428. Also, as shown *supra*, pp. 38-39, Order No. 428 standards are far broader, and appears to assume more extensive disallowances, than the *Southwestern Bell Telephone* "imprudence" standard.

As further support for its position, the Commission also urges (Br. pp. 33-34) that the two market factors

> "* * * together with the currently effective area ceiling rates, any ongoing large producer rate proceedings, and the traditional elements of a small producers' rate base—will permit a gas purchaser to estimate with confidence the limits of a reasonable small producer rate."

In addition to the vagueness of the two market factors already discussed, *supra*, pp. 38-41 it should be noted that this further suggestion again confuses the different standard applicable to rates charged for sales by a natural gas company, on the one hand, and that applicable to the allowance of costs incurred in purchases by such a company, on the other. Thus both "the currently effective area ceiling rates" and "any ongoing large producer rate proceedings" are determined under the statute's just and reasonable rate standard. As pointed out earlier, Order No. 428 not only abandons that standard as applied to the sales by small producers but does not seek to carry it over to purchases by pipelines.

As to "the traditional elements of a small producers' rate base" (Br. p. 34), this, too, would be determined under the Act's just and reasonable rate standard and hence likewise would be inapplicable here—assuming,

of course, that there would be any such traditional "rate base" for small producers. The fact is that there is no such thing as "the traditional elements of a small producers' rate base." The Commission early recognized the infeasibility of regulating the rates charged by producers, small or large, on the basis of the individual company's cost of service. See *Permian Basin Area Rate Cases, supra* at 747-758. Instead since at least 1961 when it issued its Statement of General Policy 61-1, 28 Fed. Reg. 947 (1961) the Commission abandoned individual company costs as the basis for regulating producer rates and instead has been using rates based upon *composite* cost data. See *Permian Basin Area Rate Cases, supra* at 758-764; *Wisconsin* v. *Phillips Petroleum Co.,* 373 U.S. 294 (1963).

In sum, in addition to their other infirmities, *supra*, p. 28, fn. 20, the various factors advanced by the Commission in its brief fall far short of providing the pipelines with the guidelines to which they are undoubtedly entitled so that they can "estimate with confidence" (Comm. Br., p. 34) the price they can pay for small producer gas free from the risk of disallowance. While the pipelines do not have a "risk-free guarantee * * * that they will be able to pass on to consumers all the costs they incur, however unreasonable, those costs may be" (Comm. Br. p. 34), they are entitled to guidelines which are sufficiently clear to enable them to determine whether or not the costs for small producer gas being incurred by them are "unreasonably high * * *." The criteria provided in this regard in Order No. 428 fall far short of providing such guidance.

## III.

## THE REASONS ADVANCED BY THE COMMISSION IN PURPORTED JUSTIFICATION OF ORDER NO. 428 ARE UNSOUND, INVALID, AND UNSUPPORTED BY THE RECORD

Even assuming *arguendo* that the Commission has the authority in appropriate circumstances to shift from direct to indirect rate regulation of small producers as provided in Order No. 428, Order No. 428 would nevertheless be unlawful because the reasons here advanced in purported jurtification of these actions are unsound, invalid, and unsupported by the record. In this regard, it should be noted that despite the obvious importance and impact of Order No. 428, that Order was issued without the benefit of an evidentiary hearing and solely on the basis of written comments and a single informal conference of relatively brief duration.

As noted in the Statement, *supra*, p. 4, (see also Comm. Br. pp. 23-24), the Commission issued Order No. 428 as part of its program directed at alleviating the present acute shortage of natural gas. According to Order No. 428 (J.A. 137), the proposed exemption "should encourage small producers to increase their exploratory efforts which are so important to the discovery of new sources of gas," thereby constituting "an important step forward" in the meeting of the "Commission responsibilit[y] under the Natural Gas Act * * * to assure maintenance of an adequate gas supply for the interstate market." (See, also, Comm. Br., pp. 23-25).

Tennessee, of course, is fully aware of the intensifying shortage of natural gas and is entirely sympathetic with the Commission's efforts to provide the stimuli needed to encourage the requisite exploration for and

development of the needed gas reserves. However, as shown below, far from making more gas available for the interstate markets, exempting small producers from direct rate regulation generally under the Natural Gas Act will more probably have the opposite effect. Moreover, whatever stimulus the exemption might provide to small producers to engage in additional exploration and production activities, would be at a cost to the ultimate consumers grossly disproportionate to the benefits resulting therefrom. Finally, exempting small producers from direct rate regulation is not justified as a means of relieving either the Commission or small producers of the administrative burdens of regulation.

In this regard there should be noted the restraint in the Commission's statement in its brief before the Court of Appeals (at pp. 20-21), as compared to Order No. 428 and its position before this Court (Br. pp. 23-27) that:

> "* * * The Commission's action does represent a progressive step forward in meeting the gas supply problem—a step that *should* enable jurisdictional purchasers to more effectively compete with intrastate buyers for available gas owned by small producers. In any event, it *should* encourage small producers to search for and produce more gas, thereby making additional gas available to the intrastate market (fn. omitted) * * *."

**A. The Exemption Will Probably Depress, Rather Than Stimulate, Exploration and Development by Small Producers**

Inasmuch as the Commission is already engaged in providing incentives to producers generally, small as well as large, as part of its broad scale efforts to stimulate them to increase their exploratory efforts, the Commission's issuance of Order No. 428 necessarily as-

sumes that the small producers need the *additional* incentives over and above those provided to producers generally, in order to stimulate the small producer exploratory efforts to the appropriate level. But, there are no findings in the Order No. 428 and no basis in the record made in connection with that Order—other than possibly the self-serving and untested conclusory assertions by small producers—to support that assumption.

For example, there is nothing in the record to indicate the small producers' reaction to the incentives already provided to producers generally. Nor is there anything in the record to indicate how many of the thousands of small producers which would be exempted from direct rate regulation under Order No. 428 have historically engaged in exploratory or developmental drilling programs or how many would initiate drilling programs in response to the additional incentives which the Commission was seeking to provide through Order No. 428. Thus, for all that appears on the record, many thousands of small producers may not engage in any new drilling programs and yet will receive the benefits of the exemption provided in Order No. 428 at the expense of the pipelines and consumers. The Commission's failure to address itself to these critical questions destroys whatever validity its action might otherwise have.

Indeed, far from stimulating substantial additional drilling activities on the part of small producers, exempting such producers from direct rate regulation under the Natural Gas Act would in all probability, have a contrary effect. Inasmuch as the exemption will apply only to the first 10,000,000 Mcf of the annual volumes sold by a small producer, this limitation imposes a ceiling upon the volumes of gas which such producers

would be willing to sell on the interstate markets. Obviously, if a producer's sales are already at or near the 10,000,000 Mcf per year level, the exemption would provide him with no incentive at all.

The exemption device will thus provide an incentive, if at all, for small producers to engage in exploratory activities and sell additional gas on the interstate markets *only if* their sales are well below 10,000,000 Mcf per year and then *only to the extent* that the new sales do not increase their total sales above the 10,000,000 Mcf per year level. As that ceiling is approached, the incentive, if any, will be either not to undertake further exploration or development or to sell gas on the intrastate markets in order to obtain the unregulated price which the Commission assumes producers require in order to undertake an exploratory drilling program.

Significantly, the record contains no breakdown of small producers in accordance with the level of their annual sales either generally or vis-a-vis their past exploration and development activities. Instead, it assumes that all "small producers" are equally able to undertake expanded exploration and development activities and that all will respond equally to the incentive being offered. Common sense indicates, however, that the smaller the "small producer" the less able is he financially to undertake extensive exploration and gathering activities. It is the larger "small producers" who are in the better financial position to react to the Commission's incentive. Yet, it is precisely these larger "small producers" who are the most likely to be caught by the 10,000,000 Mcf level and hence are the ones to whom Order No. 428 offers the least incentive.

In these circumstances, the Commission's claim (Br. p. 11) that "[s]mall producers [are] traditionally responsible for 80 percent of natural gas exploration"

has no meaningful significance.[24] Not only does the 80 percent figure refer back to a time when the level of a producer's sales was immaterial from a regulatory point of view but it casts no light on the level of sales made by producers who were engaged in exploration and development.

The proposed exemption would have a depressant effect upon the availability of new gas for the interstate markets in still another way. Order No. 428 provides that (J. A. 140):

> "* * * The royalty interests stand in the same shoes as the working interest owners. Consequently, if a royalty interest relates to a small producer sale, such interest shall be exempt, but if it applies to any other sale it will not be exempt."

Since the effect of this provision is that the royalty payments by small producers would be based in the "market value" nonregulated price whereas royalty payments by large producers would be based on the lower regulated price, a landowner would obviously prefer to lease his potential gas-producing properties to small producers, with the results just discussed.

### B. The Cost Increases to Pipelines and Ultimate Consumers Are Grossly Disproportionate to the Benefits

As already indicated, the small producer exemption from rate regulation applies to *all* those qualifying as "small producers" whether or not they engage in exploration and development activities as a result of the exemption provided in Order No. 428. Thus, Order No.

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[24] The 80 percent figure thus invoked by the Commission has no basis either in Order No. 428 itself or in the limited record made in connection with the issuance of that Order.

428 inevitably operates to permit increased costs to the pipelines and ultimate consumers wholly without regard to any increased exploration and production activities undertaken by the small producers.

Order No. 428 further operates to increase the costs to the pipeline and the ultimate consumers without regard to increased exploration and production activities by including *existing* small producer contracts within the exemption. This means, for example, that a small producer who is selling at or near the 10,000,000 Mcf per year ceiling, will be entitled to the benefits of the exemption with respect to his *existing* contracts even though, as noted earlier, the exemption itself would provide him with little, if any, incentive to explore for, and produce, more gas for the interstate markets.

These additional costs would be in addition to those which would result under Order No. 428 to the extent that the incentive offered by that Order in fact operates to induce such small producers to make more gas available to the interstate market. To the extent that the exemption stimulates exploratory activity by small producers and such activity results in an increase in the volume of gas available to the interstate market by such producers, it would increase the volume of gas produced by small producers generally and to this extent undercut the Commission's second reason for exempting them from rate regulation under the Act, namely, that such exemption would not have a significant impact upon the costs incurred by the purchasing pipelines and passed on in the rates paid by the ultimate consumer (J. A. 137).

In this regard, it should be noted that the Commission's claim (J. A. 137; Br. p. 24) that small producers

accounted for 10.5 percent of gas purchases by 96 pipelines in 1969 has no support in the record.[25] More importantly, the Commission's present attempt to treat the impact of its proposed exemption of small producers from Commission regulation as *de minimis* is at odds with its earlier determination on a full hearing record in the *Permian Basin Area Rate Cases, supra*. In there denying comparable requests that small producers should be exempted from area rate ceilings, the Commission emphatically stated (34 F.P.C. at 235):

> "A basic consideration in reaching our conclusion in this matter is that the impact of small producer prices on consumers is by no means *de minimis* on an area basis, and is of great impact in some situations. Sales by small producers constitute 80 percent of the gas supply of one pipeline (fn. omitted) and range from 9 percent to about 60 percent of the supply of the other 25 largest pipelines. While small producers represent only 15 percent of the aggregate interstate gas supply it is obvious that they are a substantial factor in the cost of the gas supply of millions of American consumers."

In the same vein, the Commission further observed in *Permian* (*Ibid.*):

> "Another consideration which weighs with us is that penetration of rate ceilings even on a small scale could be seriously disruptive of a pattern of uniform area ceilings."

Apart from these inconsistencies in the Commission's position in *Permian* and here, it is readily de-

[25] Although such statistical computation purports to be based on 1969 data submitted to the Commission by the pipelines, the statistics and computations based thereon are not a part of the record and have not otherwise been made available.

monstrable that the Commission's present computations operate grossly to understate the impact of the proposed exemption even assuming *arguendo* that the computations are themselves arithmetically correct. Not only does the use of averages serve to conceal the magnitude of small producer sales to a number of pipelines (see *Permian Basin Area Rate Case, supra,* at 235), but the statistics used by the Commission admittedly "do not include resales to pipelines by large producers of gas purchased from small producers." (J. A. 137, fn. 1). Yet Order No. 428 explicitly includes such resales within the proposed exemption, and the transcript of the informal conference held indicates that the volumes involved may well be very substantial.

For example, while he could not quantify the volume purchased from small producers, counsel for Phillips Petroleum Company, one of the largest producers, indicated at that conference that between 40 and 50 percent of its total jurisdictional sales represented purchases from other producers (including small producers) (J. A. 113). Counsel for Signal Oil and Gas Company similarly stated that Signal has:

> "* * * very, very little production of [its] own. Almost 100% is purchased from other producers * * * * * * It looks to us like between 60 and 70 percent of the gas that we sell presently comes from small producers." (J. A. 131).

Since Phillips and Signal are but two of the large producers, it is apparent that the volumes of gas now being sold which would come within the exemption would be substantially greater than indicated by the statistics relied on by the Commission.[26]

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[26] The nature of the underlying rulemaking proceeding and the lack of an evidentiary record makes it impossible to ascertain the full thrust of the proposed exemption.

In any case, even as adjusted to include such large producer resales, the Commission's statistics would still fall short of reflecting the true impact of the exemption. This is so because (1) the statistics used relate to a period when the proposed exemption was unavailable, and (2) the very purpose of the proposed exemption is to encourage increased exploration, and thereby, to increase the production and sale of gas by small producers in the interstate markets. To the extent that this purpose is achieved and brings about the sought-after increase in small producer sales, the result would be in increased impact upon the pipelines and their ultimate consumers. Plainly, therefore, the statistics relied on by the Commission greatly understate the impact of the proposed exemption upon the pipelines and their ultimate consumer.

### C. Order No. 428 Is Unnecessary To Reduce the Administrative Burdens Upon the Small Producers and the Commission

As a further reason for issuing Order No. 428, the Commission has urged that the exemption would "relieve the small producer of the expenses and burdens relating to regulatory matters" (J. A. 137). But this argument loses its force in light of the fact pointed out, *supra*, p. 23, fn. 17, that by Order No. 308, issued in 1965 and thereafter extended, the Commission has already relieved the small producers in the Permian Basin, Southern Louisiana and certain areas from the need to file certificate and rate applications as long as the rates charged do not exceed the applicable area rates. Extension of this provision to the remaining producing areas would be sufficient to relieve the small producers of most of the expenses and administrative burdens relating to regulation. Plainly, therefore, it is unnecessary also to exempt small producers from direct

rate regulation in order to minimize the administrative burdens of regulation upon such producers.

Likewise without merit is the Commission's related reason, *i.e.,* that the exemption would ease its "administrative burdens connected with processing small producer filings" (J. A. 137). The reduction in small producer filings provided in Order No. 308, would also serve to reduce the Commission's administrative burden vis-a-vis small producers to a minimum without the further step of exempting such producers from direct rate regulation under the Act.

Indeed, exempting small producers from direct rate regulation as well as from filing requirements generally would increase, rather than reduce further, the Commission's administrative burdens vis-a-vis small producers. Under Order No. 428, the Commission not only will have to receive for filing and processing each small producer's contracts and amendments thereto, albeit as filed by the pipelines and large producers, but it will also have the administrative problems of collecting the relevant materials and reviewing the multiplicity of prices at which the small producers would be selling to the pipelines and large producers the gas produced by them under varying circumstances from a variety of fields.

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that this Court should affirm the judgment of the Court of Appeals setting aside the Commission Order No. 428 here under review.

Respectfully submitted,

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January, 1974

## APPENDIX

The Natural Gas Act, 52 Stat. 821, 15 U.S.C. 717 *et seq.* provides in pertinent part as follows:

NECESSITY FOR REGULATION OF NATURAL-GAS COMPANIES

SECTION 1. * * * (b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

* * *

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * *

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-

gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * *

ADMINISTRATION POWERS OF COMMISSION; RULES, REGULATIONS, AND ORDERS

SEC. 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission

shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

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FEDERAL POWER COMMISSION, *ET AL.*,
*Petitioners,*

v.

TEXACO INC., *ET AL.*,
*Respondents.*

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**On Writs of Certiorari**
**To The United States Court of Appeals**
**for the District of Columbia Circuit**

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## BRIEF FOR THE RESPONDENT, PHILLIPS PETROLEUM COMPANY

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Phillips Petroleum Company ("Phillips"), a Respondent before this Court and a Petitioner below, files this brief in response to briefs of the Solicitor General on behalf of the Federal Power Commission ("Commission"), Dudley T. Dougherty, *et al.*, Co-Executors of the Estate of Mrs. James R. Dougherty, *et al.* ("Dougherty"), the Independent Petroleum Association of America ("IPAA"), and the Small Producers Group.

Phillips accepts the statements in the brief of the Commission with respect to the Opinion Below, Jurisdiction, and Statutes Involved.

## QUESTIONS PRESENTED

1. Can the Commission lawfully avoid its statutory duty to see that all rates are just and reasonable?

2. Can the Commission lawfully abridge its procedures for small producers if the result is to deny effective protection to consumers?

3. Can the Commission lawfully shift the burden of regulation and the burden of regulating to large producers and pipelines?

4. Can the Commission issue an order which unfairly discriminates in favor of small producers and pipelines and against larger producer plant owners?

## STATEMENT OF THE CASE

### A. BACKGROUND

1. In 1954 this Court held, in *Phillips Petroleum Company* v. *Wisconsin,* 347 U.S. 672,[1] that the Natural Gas Act ("Act") *requires* the Federal Power Commission to regulate wellhead sales for resale of natural gas in interstate commerce. For six years the Commission had staunchly sought to avoid this regulatory burden. The Court found, however, that

> "* * * the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce. . . ."[2]

[1] Hereinafter referred to as the "first Phillips" case.

[2] 347 U.S. at 682; emphasis added.

In response, the Commission set up procedures for producers to file their contracts with the Commission, to apply for certificate authority to make sales, and to effectuate contractually authorized rate increases. Perhaps more importantly, it initiated a rate case[3] in which it developed the basic methodology for determining just and reasonable producer rates under Sections 4 and 5 of the Act. Using this methodology, the Commission determined that the producer rates of Phillips were not unjust or unreasonable.[4]

From its experience in that initial producer rate case, the Commission concluded that an individual company approach to producer rate regulation was impractical, and, accordingly, it initiated its so-called "area rate proceedings" in which just and reasonable rates would be fixed for all jurisdictional producer sales in particular geographic areas.[5] In the first such area rate case to reach Commission resolution, the methodology which had been developed was again utilized under Sections 4 and 5, but this time to set just and reasonable rates for all jurisdictional producer sales made in the Permian Basin area of Texas and New Mexico.[6] This Court affirmed the Commission's area rate methodology and its application in the 1968 *Permian* case.[7]

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[3]Phillips Petroleum Company, Docket Nos. G-1148, et al.

[4]Phillips Petroleum Co., 24 FPC 537 (1960), aff'd sub nom., Wisconsin v. Federal Power Commission, 373 U.S. 294 (1963). This latter decision is hereafter referred to as the "second Phillips" case.

[5]In the second Phillips case, in addition to upholding the commission with respect to the producer rates in question, this court also upheld the Commission's conclusions as to the need for the area rate approach for subsequent producer rate determinations.

[6]Area Rate Proceeding (Permian Basin Area), Opinion No. 468, 34 FPC 159 (1965), aff'd sub nom., Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

[7]Permian Basin Area Rate Cases, supra.

Since issuing its *Permian* order on August 5, 1965, the Commission has determined just and reasonable area ceiling rates for almost all major producing areas in the country.[8]

2. Subsequent to the Commission's *Permian* order there have been significant procedural developments which have considerably reduced the time required by the Commission for determining just and reasonable area rates. For example, in the first *Permian* case, the record was made between July 17, 1961 and September 10, 1963; there were over 200 hearing days and 30,000 pages of transcript; the initial decision was issued on September 17, 1964; and the Commission's Opinion

[8] Area Rate Proceeding (Southern Louisiana Area), Opinion No. 546, 40 FPC 530 (1968), affirmed, Southern Louisiana Area Rate Cases, 428 F.2d 407; on rehearing, 444 F.2d 125 (5th Cir. 1970), certiorari denied, 400 U.S. 950; Area Rate Proceeding, et al. (Hugoton-Anadarko Area), Opinion No. 586, 44 FPC 761 (1970), affirmed, 466 F.2d 974 (9th Cir. 1972); Area Rates for the Appalachian and Illinois Basin Areas, Order No. 411, 44 FPC 1112 (1970); Area Rate Proceeding, et al. (Texas Gulf Coast Area), Opinion No. 595, 45 FPC 674 (1971), reversed, Public Service Commission for the State of New York v. Federal Power Commission, D.C. Cir., No. 71-1828, August 24, 1973, pending on petitions for certiorari in Nos. 73-966, et al.; Area Rate Proceeding, et al. (Southern Louisiana Area), Opinion No. 598, 46 FPC 86 (1971), affirmed, Placid Oil Company v. Federal Power Commission, 483 F.2d 880 (5th Cir. 1973), pending on petitions for certiorari, Nos. 73-437, et al.; Area Rate Proceeding, et al. (Other Southwest Area), Opinion No. 607, 46 FPC 900 (1972), affirmed, Shell Oil Company v. Federal Power Commission, 484 F.2d 469 (5th Cir. 1973), pending on petition for certiorari, No. 73-438; Area Rates for the Rocky Mountain Area, Opinion No. 658, April 11, 1973, appeal pending, Exxon Corporation, U.S.A. v. Federal Power Commission, D.C. Cir. No. 73-1854; Area Rate Proceeding (Permian Basin Area II), Opinion 662, August 7, 1973, appeal pending, Chevron Oil Company v. Federal Power Commission, 9th Cir., No. 73-2861.

468 was issued on August 5, 1965. In the second *Permian* case,[9] the hearing record was made between July 17, 1971 and January 11, 1972; there were only five hearing days and less than 1300 pages of transcript; the record from a slightly earlier area rate proceeding was incorporated by reference; the initial decision was issued on December 20, 1972; and the Commission's Opinion 662 was issued on August 7, 1973.

In addition, the Commission has asserted the right to set just and reasonable area ceiling rates by informal rulemaking.[10] Using this rulemaking procedure the Commission has issued one set of area ceiling rates which is now final[11] and another set[12]

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[9] Area Rate Proceeding (Permian Basin Area II), Opinion No. 662, appeal pending, Chevron Oil Company v. Federal Power Commission, 9th Cir. No., 73-2861.

[10] The appropriateness of this technique has been affirmed by the Ninth Circuit, Phillips Petroleum Company v. Federal Power Commission, 475 F.2d 842 (1973), although the D.C. Circuit has rejected it, Mobil Oil Corporation v. Federal Power Commission, 483 F.2d 1238 (1973). Petitions for certiorari addressed to the Ninth Circuit are pending in Chevron Oil Company, et al. v. Federal Power Commission, Nos. 73-91. The relevance of the rulemaking procedure to the instant cases is discussed at pages 00-00, below.

[11] Area Rates for the Appalachian and Illinois Basin Areas, Order Nos. 411, 44 FPC 1112 (1970).

[12] Area Rates for the Rocky Mountain Area, Docket No. R-425, Opinion No. 658, issued April 11, 1973.

which is now before the D.C. Circuit.[13] It also has decided to use this rulemaking procedure to set nationwide ceiling rates;[14] and this nationwide ratemaking technique, if upheld, would eliminate the need for periodic rate determinations for the several geographic areas previously involved in area-rate proceedings, thus cutting the time to minimum dimensions. Further, the Commission has established the "Optional Certificate Procedure" whereby it is undertaking to make both a certificate determination and a prospective just and reasonable rate determination in a single, unified proceeding.[15] Such proceedings

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[13]Exxon Corporation, U.S.A. v. Federal Power Commission, No. 73-1854.

[14]Just and Reasonable National Rates for Future Sales of Natural Gas from Wells commenced on or after January 1, 1973, Docket No. R-389-B, Notice issued April 11, 1973 38F.R. 10,014 (April 23, 1973); Nationawide Rulemaking to Establish Just and Reasonable Rates for Natural Gas Produced from Wells commenced before January 1, 1973, Docket No. R-478, Notice issued May 23, 1973 38F.R. 14,295 (May 31, 1973).

[15]Optional Procedure for Certificating New Producer Sales of Natural Gas, Order No. 455, 48 FPC 218, appeal pending, Moss v. Federal Power Commission, D.C. Circuit No. 72-1837.

now appear to be routine, and the time consumed appears to be about 6 to 8 months.[16]

Thus the Commission has adopted many new procedures for determining just and reasonable producer rates, procedures which are being used more and more frequently and which require less and less time.

On top of this picture should be superimposed the Commission's treatment of small producers, including the orders under review.

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[16]More than 70 applications for optional certificates have been filed since August of 1972. The Commission has issued favorable opinion in two cases, Belco Petroleum Corporation, et al., Opinion No. 659, issued May 30, 1973, and Felmont Oil Corporation, Opinion No. 676, issued November 30, 1973, while issuing one opinion denying an application to Corbin J. Robertson in Northern Michigan Exploration Company, Opinion No. 668, issued October 23, 1973.

In addition, at least seven initial decisions by administrative law judges have been issued, five approving and two denying applications. And at least four applications have been approved by the Commission pursuant to its shortened procedure for uncontested cases, 18 C.F.R. Subchapter A, Part 1, § 1.32 (1973). At least seven more cases are presently set for hearing.

The time consumed in reaching final decisions in these cases appears to range from five and one-half months (Pennzoil Producing Company, Docket No. CI72-321, application filed April 27, 1973, order issued October 12, 1973) to eight months (Felmont Oil Corporation, Opinion No. 676, supra, application filed March 28, 1973, order issued November 30, 1973, and Getty Oil Company, Docket No. CI73-593, application filed March 8, 1973, order issued October 25, 1973).

3. As we mentioned above, the Commission issued its producer regulations shortly after the first *Phillips* case.[17] Even then, the Commission was aware of the difficulties that might be presented by having to regulate many small producers; but it felt compelled by *Phillips* to reject any treatment of small producers that might amount to an exemption from regulation:

> "5. Some of the petitions urged that the regulations be amended to relieve small producers from the requirements of the statute. The Act does not provide for exemptions from its requirements . . ."[18]

The Commission, however, did recognize that small producers might be heavily burdened if they had to comply with all the procedural requirements imposed on large producers. And so as part of Order 174-B it did relieve small producers of some of those procedural requirements. For example, a producer with annual sales of less than 1,000,000 Mcf was required to file only five copies of his certificate application instead of fourteen; could use a simplified form provided by the Commission; and did not have to include copies of his contract. In addition, a very small producer, one with annual sales of less than 100,000 Mcf, did not have to file his contracts with the Commission as rate schedules, but could instead submit summaries showing only the approximate annual volume being sold, the rate charged, the purchaser, and delivery point. Also of significance was the regulation allowing all interest owners to be covered by the certificate and rate filings of the lease operator; this rule eliminated the need for every single one of the sellers to make a complete set of filings.[19]

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[17]Order No. 174-B, 13 FPC 1576 (1954).

[18]Id. at 1577.

[19]Id. at 1579-84, 1588

As might be expected, the Commission acquired additional experience regulating small producers during the next decade. Primary within that body of experience was the testimony adduced in the original *Permian* hearing on the basis of which additional regulatory short cuts were adopted for small producers. As we have already mentioned, the *Permian* record was made over a period of almost 26 months and was comprised of over 30,000 pages of transcript. Some of the evidence was introduced on the problems of the small producer, with emphasis on his difficulties in complying with the Commission's administrative requirements. There was also evidence as to the impact of small producer activities on supplies of interstate gas and, most importantly, the impact of small producer rates upon ultimate consumers (390 U.S. at 784-87).

Based on the evidence of record, the Commission in its *Permian* decision made findings of fact which established the basis for its treatment of the class. On this basis it concluded that the defining feature of the class should be annual sales of 10,000,000 Mcf or less, that certain abridged procedures would be appropriate for small producers, and that certain special pricing provisions would also be in order.[20] This Court relied on the Commission's findings of fact in its review and approval of the *Permian* decision (390 U.S. at 784-86):

> "The Commission reasoned that, in these circumstances, carefully selected special arrangements for small producers would not improperly increase consumer prices. Moreover, it concluded that such exemptions might usefully both streamline the administrative process and strengthen the small producers' financial position. The Commission provided two forms of special relief: first, it released small producers from the requirement that quality adjustments be made in price; and second, it commenced a rulemaking proceeding intended to relieve them from

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[20] 34 FPC at 235-36.

various filing and reporting obligations. See 34 FPC 434. The Commission asserted that the consequences for consumer prices of the first would be de minimus; it expected that the second would measurably reduce the small producers' regulatory expenses."[21]

It is important to note that the small producer rules thus adopted and approved in *Permian* did not encompass abandonment of the statutory just and reasonable standard. On the contrary, producer sales in the Permian area, including small producer sales, were to be made at rates no higher than the applicable just and reasonable area rate.[22] Thus, a small producer could initiate new sales at or below the area rate under a blanket certificate without prior Commission review,[23] and it could avoid all rate filings but only so long as its rate did not exceed the area rate ceiling.[24] Moreover, the Commission declined to apply its streamlined *Permian* procedures to small producer sales in other areas until just and reasonable area rates could be established for application to such sales (and other producer sales).[25] And it specified that small producers, in the annual statements which they were required to file, certify that the volumes of gas sold during the year were sold at or below the just and reasonable rate fixed by the Commission.[26]

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[21] 390 U.S. at 786, footnotes omitted. The full text of the rules is reported at 34 FPC 434 (1965).

[22] 34 FPC at 231, 235-36. See also, El Paso Natural Gas Co., et al., 35 FPC 40 (1966).

[23] 34 FPC at 235. To the same effect see also the orders issued in the related rulemaking docket: Notice of Proposed Rulemaking, Docket No. R-279, 34 FPC 434 (1965); Order No. 308, 34 FPC 1202 (1965).

[24] 34 FPC at 236.

[25] 34 FPC at 235.

[26] Id. at 236.

Thus an examination of the principal differences between the small producer regulations promulgated in Order 174-B and those based on *Permian* shows an evolution that was essentially definitional and procedural: (1) the definition of "small producer" was made uniform and was expanded to cover all producers with annual sales of 10,000,000 Mcf or less; (2) the blanket certificate was introduced so that a new application with its attendant delay was not necessary every time a small producer wanted to start a new sale; (3) the blanket certificate would carry with it exemption from the requirement to file contracts as individual rate schedules and the requirement to file rate increase notices *so long as* the rates were at or below the just and reasonable area ceiling rates; and (4) each small producer was required to file only a single, simplified statement each year showing that the small producer's sales were at or below the 10,000,000 Mcf level and were being made at or below the just and reasonable area ceiling rates.

Thus the new *Permian*-based regulations were tied inextricably to implementation of the just and reasonable rate standard.

For example, as soon as it promulgated just and reasonable rates for other areas, the Commission correspondingly extended the availability of its small producer procedures.[27] And when the *Permian* moratorium on above-ceiling rate increases lapsed, small producers were allowed to increase their rates above the just and reasonable ceiling, but only if they filed the standard notice required by Section 4 of the Natural Gas Act. This left

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[27] Area Rate Proceeding (Southern Louisiana Area), Opinion No. 546, 40 FPC 530, 612-14 (1968), affirmed, Austral Oil Co. v. Federal Power Commission, 428 F.2d 407, affirmed on rehearing, 444 F.2d 125 (5th Cir. 1970); Area Rate Proceeding, et al. (Hugoton-Anadarko Area), Opinion No. 586, 44 FPC 761, 781 789-90 (1970); Area Rates for the Appalachian and Illinois Basin Areas, Order No. 411, 44 FPC 1112, 1131-32 (1970).

them with the same suspension and refund exposure as any other producer.[28]

Thus, until the orders under review were issued, the parameters were clear: relief from burdensome filing requirements to the extent that the small producer stayed within the just and reasonable area ceiling rates.

## B. PROCEEDINGS BEFORE THE COMMISSION

When the Commission initiated the instant proceeding, the notice made it quite clear that the Commission was prepared to go much further than it ever had before. Not only was the Commission proposing to further simplify filing requirements for small producers, but it was even proposing "* * * to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers * * *" (App. 1). Further examination of the notice discloses that the only limits the Commission proposed on the exemption would be a requirement to file an annual statement setting forth the small producer's total jurisdictional sales and a *caveat* that, if a small producer should ever exceed the 10,000,000 Mcf annual limitation, sales initiated thereafter would be fully subject to regulation although his existing sales would remain exempt (App. 2-3). Gone was the *Permian* requirement that the annual statement verify that all of the small producer's sales were made at or below the just and reasonable area rates.

The proposed mechanism for extending the small producer exemption included (1) broadening of the blanket certificate's effectiveness so that it would allow the initiation of sales, without a certificate application, anywhere in the country rather than just in those areas where just and reasonable area

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[28] Area Rates for Small Producers (Permian Basin Area)—Increased Rate Filings, Order No. 394, 43 FPC 16 (1970). See also the Notice issued in Docket No. R-374 on November 4, 1969 for an additional discussion of the Commission's views (34 F. Reg. 18180 (November 13, 1969)).

ceiling rates have been set; (2) freedom to make both existing and new sales of gas at the contract rate without being restricted to the just and reasonable area ceiling rates; and (3) an annual statement listing the total volume of all sales and, separately, the area, purchaser, volume, and price of each sale.

Recognizing also that the increased costs resulting from the exemption would have to be absorbed by someone, the Commission indicated that pipeline purchasers would be able in turn to track such resulting rate increases through their rates (App.3), but it proposed that a large producer's resale of gas purchased from a small producer would remain subject to Commission jurisdiction (App. 2-3). Apparently realizing that such discriminatory treatment of large producers might not sit too well with large producers, the Commission added, "* * * If there are any problems in this regard, large producers in their comments should discuss these problems" (App. 4).

Comments were filed by a number of parties (App. 14-96), including Phillips (App. 22-31). A conference was also held (App. 97-134). In its comments, Phillips urged, *inter alia*, that the Commission has no authority to create the proposed exemption (App. 30) and that the proposed regulations would discriminate unfairly against Phillips (App. 25-30). Phillips purchases and processes significant quantities of gas from small producers for the extraction of natural gas liquids. If Phillips were restricted to the just and reasonable area ceiling rates for the resale of residue gas, it would become unable to purchase any new gas at all from small producers or else would have to pay more for such gas than it could possibly collect for its resale (App. 26). This economic restraint imposed on large producers was contrasted with the freedom the Commission proposed to allow pipelines which, for example, would be able to purchase gas from a small producer at above-ceiling prices *plus* the value of extracted liquids, all the while being able to pass all these costs along to the consumer through the proposed tracking authority (App. 27-28). Phillips specifically suggested that it be allowed to supplement its existing rate schedules to pass through above-ceiling rates to its pipeline purchasers (App. 28).

When the Commission issued its Order No. 428 (App. 135-154), it prescribed regulations applying directly to small producers which were substantially the same as proposed. Thus the effectiveness of the blanket certificate was extended to all areas of the country, even if just and reasonable area ceiling rates had not been established (App. 149); sales would be made at the contract rates irrespective of the just and reasonable area ceiling rates (App. 149); and an annual statement was prescribed without a provision assuring that all sales had been made at or below just and reasonable rates (Order No. 428-A, App. 161). Additionally, certain minor limitations were imposed.[29]

The Commission then went on, however, to deal with the objections and problems raised generally by the large producers and pipelines who buy from small producers. In response to objections that the Natural Gas Act does not allow for exemptions and that the proposed regulations would create unfair discrimination, it stated that the small producer rules it was issuing *would* amount to regulation (App. 137), because such regulation would be conducted at the pipeline level through the review of the purchased gas costs of each pipeline with respect to new small producer purchases. Although small producers would not be subjected to refund liability, the pipelines' rates related to *new* small producer sales would be subject to reduction and refund according to a new tracking test, *i.e.* "* * * as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area * * *" (App. 142).

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[29] A small producer could not abandon his sale without authorization under Section 7(b) of the Act. (App. 149). Certain indefinite pricing provisions could not be used to escalate prices above the area ceiling (App. 149-150). The exemptions would not apply to the sale of developed reserved purchased from a large producer (App. 149) and should a contract expire, the small producer could not collect anything above the highest contract rate without making a filing under Section 4 of the Act (App. 141, n.4).

Cost increases resulting under *existing* small producer sales were permitted to be passed on by pipelines without Commission review (App. 246 n. 5).

This same tracking test was also imposed on large producers, but the Commission tacked on two further requirements: (1) for the large producer to pass on such above-ceiling small producer rates, the higher rate must be contractually authorized and (2) the price differential between the purchase and resale prices must not exceed the prevailing price differential in the area (App. 150). Furthermore it would appear that these additional tests were prescribed for both existing and new small producer sales.

Eleven parties filed applications for rehearing (App. 155-158; 162-237), including Phillips (App. 221-30; as amended, App. 231-37). Phillips objected that the scheme of indirect regulation imposed by Order 428 was not fairly covered by the notice (App. 222-23), that the Commission has no authority to make exemptions like this (App. 223-25), and that the order unfairly discriminates against Phillips in a number of ways (App. 225-29); a vivid example of a pipeline's newly enhanced power to outbid Phillips for new small producer gas—an incident which occurred less than 30 days after issuance of order 428 but even before its effective date—was submitted to the Commission in an amendment to Phillips' application for rehearing (App. 231-37).

In Order No. 428-B, the Commission responded to the various applications for rehearing. Specifically with respect to complaints by large producers, the Commission allowed a large producer to resell gas newly purchased from a small producer at a higher rate designed to maintain the existing price differential, but only (1) *if* it is able to negotiate a new resale contract with the pipeline purchaser, (2) *after* it has filed a certificate application to cover such new contract, and (3) *subject* to refund down to whatever rate level is finally approved by the

Commission (App. 241, 253).[30] In most other respects, the Commission declined to make any significant changes in its small producer rules.

## C. THE DECISION BELOW

On petitions for review, the United States Court of Appeals for the District of Columbia Circuit set aside Orders 428, 428-A, and 428-B. The Court began by reviewing the Commission's goals and stated that it was not challenging either the Commission's motives or its opinion that some form of deregulation of small producers might benefit the consumers of natural gas (Pet. App. 5a). Nowhere did the Court object to the Commission's extending the effectiveness of the blanket certificate to all areas of the country or the omission of Section 4 rate filings as long as the rates meet the just and reasonable standard.

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[30] perhaps the most striking example of the discrimination against large producers was the Commission's refusal to permit them to pass on small producer increases up to the Commission-prescribed area minimum rate. The orders allow small producers to collect the minimum rate even if it is not authorized by their contracts, but large producers cannot pass these increases on. The Commission held, in effect, that although the public interest required the small producer-large producer contract to be set aside so as to permit such an increased small producer rate, nevertheless the same public interest would not permit the large producer-pipeline resale contract to be set aside to permit the flow through of that small producer increase to the pipeline and the public (App. 240-241). Ironically, the Commission relied on this Court's opinion in Federal Power Commission v. Sierra Pacific Power Co., 350 U.S. 348 (1956), to support both actions (App. 144, 240-241). The minimum price powers in area rate proceedings are exercised on the authority of Sierra; see, *e.g.*, Permian, supra, 34 FPC at 231-32.).

The Court's fundamental objection, however, was that:

"* * * The Commission may not ignore the command of Section 4 (15 U.S.C. §717(c) (a)):

> '*All* rates and charges made, demanded, or received by *any* natural-gas company for or in connection with the . . . sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful.* * *'

"The Commission must also heed similar language in Section 5 (15 U.S.C. §717(d)):

> 'Whenever the Commission, after a hearing had upon . . . complaint of any State, municipality, State Commission, or gas distributing company, shall find that *any* rate, charge or classification demanded, observed, charged, or collected by *any* natural-gas company in connection with *any* . . . sale of natural gas, subject to the jurisdiction of the commission . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission *shall* determine the just and reasonable rate, charge, classification . . . or contract to be thereafter observed and in force, and *shall* fix the same by order . . .' "[31]

In the Court's view, the Commission, if it were operating under these small producer rules, simply could not meet its obligations under the Act "* * * to assume 'jurisdiction over the rates of *all* wholesales of natural gas in interstate

[31] Pet. App. 7a-8a; emphasis by the Court; footnote omitted.

commerce' . . . to insure that all such rates comply with the statutory standard."[32] First, the Natural Gas Act does not allow for such exemptions, as does, for example, the National Labor Relations Act (Pet. App. 8a-9a). Second, the Commission's power to classify persons subject to its jurisdiction cannot be used to exempt indirectly when the Commission could not exempt directly; further the power to classify and to issue rules and regulations can only be used to carry out the Commission's obligations under the Act, not to avoid them (Pet. App. 9a-10a). Third, the Court completely rejected the indirect regulation of small producer prices as urged by the Commission because the "unreasonably high" standard is simply not the equivalent of "just and reasonable" and is tied to factors which the Commission does not and cannot regulate (Pet. App. 11a-13a). In conclusion the Court said, " * * * we cannot hold that *non*regulation is the statutory equivalent of regulation * * *"[33]

Judge Fahy dissented, stating his belief that the Commission was engaged in an experiment to see whether a higher rate than that previously fixed for the industry in the area may be just and reasonable for the small producer as a separate classification within the area (Pet. App. 20a). It appears (although we are not certain) that Judge Fahy would avoid disturbing the orders until the Commission had concluded review of its experiment (Pet. App. 20a-21a). He did, however, recognize that large producers and pipelines are themselves consumers; and so he would strike those provisions of the order absolving small producers from any refund obligation even for those rates which the Commission eventually finds to be unreasonably high (Pet. App. 22a).

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[32]Pet. App. 8a; emphasis by the Court. The Court of Appeals also added (Pet. App. 8a):

> "[10] The Supreme Court has described 'the Fixing of "just and reasonable" rates' as 'the heart of the new regulatory system.' *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944)."

[33]Pet. App. 16a; emphasis added by the Court.

## SUMMARY OF ARGUMENT

It should be recognized from the start that Phillips does not challenge the Commission's power to separately classify small producers and prescribe special treatment for them. But the Commission has not seen fit to do just that. Instead it has totally exempted them from the just and reasonable standard of the Act. In doing so it has simply gone too far. It has no authority to so exempt. It has precluded effective consumer protection. It has placed the burden of regulation on the wrong parties. And it has unfairly discriminated against large producers. The orders therefore must fall.

First, the orders do *exempt* all small producer rates from the just and reasonable and initial certification standards required by the Natural Gas Act. The Commission has no authority to exempt such sales from the standards of the Act because under Commission and judicial precedent the standards of the Act are mandatory and allow for no Commission-created exceptions. The small producer regulations which have been approved in the past offer no valid precedent because the former regulations were procedural in nature and were always specifically restricted to situations where the small producers' rates were subject to the just and reasonable area ceiling rates.

Second, the "indirect regulation" which the Commission offers is not an adequate substitute for the direct regulation it has abandoned. The Commission's substitute standards assume prices in excess of just and reasonable rates. Moreover, nothing assures us that the Commission ever will scrutinize such above-ceiling rates. And, even if it should, there is no procedure for protecting the consumers against excessive rates until the Commission finally does get around to acting.

Third, the Commission's intention to review small producer rates through its review of resale rates of large producers and pipelines purchasing from small producers constitutes an illegal attempt to shift the burden of regulation from the small producers to large producers and pipelines. The Commission

has provided no definite standards and, as a result, such large producers and pipelines must act at their peril—gamble that the small producer rates will ultimately be viewed favorably by the Commission. Further, the Commission has attempted to make regulated companies do the job of regulators although Congress has directed that the Commission exercise this responsibility.

Fourth, the Commission has unduly discriminated against large producers, contrary to the Act and the Commission's Rules and Regulations, and in violation of constitutional requirements and standards. Undue preferences have also been accorded small producers and pipelines.

For all of these reasons, Phillips submits that the Court of Appeals correctly set these orders aside.

## ARGUMENT

### I.

### THE COMMISSION HAS NO POWER TO EXEMPT JURISDICTIONAL SALES FROM THE REQUIREMENTS OF THE NATURAL GAS ACT

#### A. The Commission Has Exempted Small Producer Sales from Rate Regulation.

There should be no mistake about it. The Commission's orders go well beyond the small producer rules adopted in *Permian* and exempt small producer sales from rate regulation. Both the Commission's brief (page 13) and Dougherty's Brief (page 25) urge that, under the new small producer rules, small producer *rates* will be just and reasonable. The Commission's orders themselves, however, make it clear that the just and reasonable standard would never again be applied directly to the

rates charged by small producers themselves.[34] A small producer is free to charge whatever his contract calls for and "* * * the provisions of that contract will not be subject to change" (App. 249). Thus, even if the Commission should find a small producer rate improper for pass-through, the small producer would have no refund obligation and would not even have to reduce his rate prospectively to the level found proper by the Commission.[35] Further, it is simply a logical impossiblity that the same rate could at the same time be just and reasonable for a small producer but unjust and unreasonable for the large producer or pipeline which is merely selling the same gas and passing on the same rate.

The rate review which is precluded during the life of a small producer sale is also absent at its commencement, for under his blanket certificate a small producer can begin any sale as soon as the purchaser is able to start taking, without any necessity to await Commission scrutiny of the sale. Again, this procedure is radically different from the *Permian* small producer rules which permitted new sales to be initiated under the blanket certificate only if the rate did not exceed the just and

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[34]The regulations issued by the Commission quite specifically refer to the "exemption" therein authorized no less than 7 times on a single page and once to "* * * any small producer sale exempted hereunder * * *" (App. 149).

[35]It must have come as quite a shock to small producers to see Commission Counsel's claim that the Commission remains free to order prospective reduction of a small producer's rates under Section 5(a) of the Act (Brief, page 15). The justification relied upon would appear to be the Commission's cryptic promise in Order 428 to "take further action" if its "review" of new small producer rates establishes something "inimical to the interests of consumers" (App. 145). In view of the Commission's attempt to "assure" the small producer that his "contract will not be subject to change" (App. 249) and in view of the blanket certificate authorization to sell gas "at the price specified in each . . . contract" (App. 149), there is doubt that the Commission would be at all free to initiate a Section 5(a) proceeding against any small producer. Civil Aeronautics Board v. Delta Air Lines, Inc., 367 U.S. 316, 333-34 (1961); United States v. Seatrain Lines, Inc., 329 U.S. 424 (1947).

reasonable area rates.

### B. The Natural Gas Act and Judicial Precedent Require that the Commission Regulate Small Producer Sales by the Statutory Standards.

The Natural Gas Act was adopted as a corrective measure. It was framed not to penalize certain proscribed acts, but to prevent their occurring at all. As a principal objective, Congress sought to prevent "natural-gas companies" [36] from charging excessive rates for jurisdictional sales of natural gas. So it proscribed such rates and instructed the Commission to regulate and determine rates under the just and reasonable standard of Sections 4 and 5.

Congress left no ambiguity in the statutory language establishing the Commission's obligation to review rates. Section 4(a) states that:

> "*All* rates and charges . . . for . . . the . . . sale of natural gas . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful."[37]

Since the provision could not be self-executing, Congress established the forum and the procedure for Commission scrutiny of rates:

> "(c) * * * every natural-gas company shall file with the Commission . . . all rates and charges for any . . . sale * * *.

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[36]Section 2(6) of the Act defines a "natural-gas company" to be "a person engaged in . . . the sale of natural gas in interstate commerce . . . for resale" 52 Stat. 821(1938); 15 U.S.C. §717a.

[37]Natural Gas Act, Section 4(a), 52 Stat. 822 (1938), 15 U.S.C. §717c(a); emphasis added.

"(d) * * * no change shall be made by any natural-gas company in any such rate . . . except after thirty days' notice to the Commission and to the public * * *.

"(e) Whenever any such new [rate] . . . is filed the Commission shall have authority . . . to enter upon a hearing concerning the lawfulness of such rate . . . ; and, pending such hearing . . . the Commission . . . may suspend the operation of . . . such rate . . . but not for a longer period than five months * * * [T]he Commission may . . . upon completion of the hearing and decision . . . order such natural-gas company to refund, with interest, the portion of such increased rates or charges . . . found not justified."[38]

And this Court has spoken pointedly of the Commission's obligation, under these provisions of the Act, to, at least, review rates *before* they become effective:

"* * * the Act provides . . . for *notice* to the Commission of the rates established by natural gas companies and for *review* by the Commission of those rates.§ 4(d) means simply that *no* change—neither a unilateral change to an ex parte rate nor an agreed-upon change to a contract—can be made by a natural gas company without the proper notice to the Commission. * * *" [39]

Section 5 of the Act requires, whenever any rates are found to be unjust and unreasonable, that the Commission thereupon determine just and reasonable rates. This section operates prospectively only since a rate proceeding thereunder

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[38]Natural Gas Act, Sections 4(c), 4(d), and 4(e), 52 Stat. 822 (1938), as amended 15 U.S.C. § §717c(a), 717c(e).

[39]United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332, 343 (1956).

is not initiated by a rate increase filing. Moreover, there is no power to suspend or prescribe refunds.

The Natural Gas Act, of course, contains two exceptions[40] and one exemption provision,[41] but they are strictly construed, *Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U.S. 682, 690-91 (1947); and no one has even suggested their relevance to this case.

As we have already mentioned, once this Court made it clear in the first *Phillips* case that producer *sales* are jurisdictional and not within the production and gathering exemption of Section 1(b), the Commission set about developing the regulatory technique for setting just and reasonable producer rates.

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[40]Section 1(b), 52 Stat. 821 (1938), 15 U.S.C. §717(b) provides:

> "(b) The provisions of this Act . . . shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 1(c) 68 Stat. 36 (1954), 15 U.S.C. §717(c) provides:

> "(c) The provisions of this Act shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. * * *"

[41]Section 7(c), 52 Stat. 825 (1938), as amended, 56 Stat, 83 (1942); 15 U.S.C. §717F(c) provides:

> "* * *the Commission . . . may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest."

The entire course of this development was based on the requirement that *all* jurisdictional producer sales must be regulated under the mandatory statutory standard. Small producer sales were always included although small producers as a class admittedly received special treatment. Thus the Court's *Permian* decision can only be read as approving special treatment for small producers in a situation where their sales were subject to just and reasonable ceiling rates along with those of the large producers.[42] *Permian* did not approve an exemption from the just and reasonable standard of the Act. Rather it held that where compliance with that standard is provided for, the Commis-

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[42] The following excerpts from Opinion No. 468 demonstrate the Commission's considerations in issuing its small producer regulations in Permian. Despite a recommendation by the Examiner that all small producer rates be approved at their contract levels, the Commission insisted on the applicability of the just and reasonable standard to small producer sales (34 FPC 234-36; emphasis added):

> "In our opinion the salutary objectives of those who propose exemption can better be achieved *within the framework of regulation.* * * *
>
> "A basic consideration in reaching our conclusion in this matter is that the impact of the small producer prices on consumers is by no means *de minimis* on an area basis, and is of great impact in some situations. * * *While small producers represent only 15 percent of the aggregate interstate gas supply it is obvious *they are a substantial factor in the cost of the gas supply of millions of American consumers.*
>
> * * * * *
>
> "Sales in areas other than the Permian Basin by small producers will not be eligible for coverage by such certificates *until an area rate is fixed therein because the determination of a specific area rate is a prerequisite for the issuance of such certificates.*
>
> * * * * *
>
> "* * *Of course, no increases above the applicable area ceiling will be permitted without the approval of the Commission pursuant to the filing requirements of Section 4(d). * * *"

sion may abridge certain of its procedures.[43]

Thus it is clear that there is no statutory or judicial basis for exempting small producers from the just and reasonable standard of the Act. Since *exemption* from that standard is precisely what the orders accomplish, they must be set aside.

## II.

## THE "INDIRECT REGULATION" PROVIDED BY THE COMMISSION DOES NOT EFFECTIVELY PROTECT THE CONSUMER

Since the orders preclude the regulation of small producer rates, the Commission seeks to save its orders by promising us "indirect" regulation. Like so many labels, however, this one only diverts our attention from what really lies underneath. The Commission has voluntarily relinquished so many of its regulatory tools that with those which remain the Commission cannot fulfill the role prescribed by Congress. The remaining regulatory skeleton does not adequately protect consumers as the Act requires. We believe that the Court of Appeals correctly

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[43]The Commission's brief suggests (page 4) that statements by Mr. Justice Clark in dissent (Wisconsin v. Federal Power Commission, 373 U.S. 294, 329-30) and for the Court (Federal Power Commission v. Hunt, 376 U.S. 515, 527) lend support to the Commission's assertion of authority to exempt small producers as part of its efforts to regulate producer sales. The cited language, however, goes no further than recommending to the Commission a study to determine whether certain exemption procedures available to other agencies under other statutes might also be appropriate for the Commission. There was no hint at all that this Court had itself made such a study and even less than it was holding such exemption procedures to be available under the existing statutory language. See also the Court of Appeals' discussion of this area, Pet. App. 8a-9a.

assessed such indirect regulation when it said (Pet. App. 12a-13a).

> "* * * At best, the indirect controls it has proposed will insure that the small producer rates which are passed on to consumers are below levels set by private contracting parties (or . . . by state regulation . . . ). Nothing at all insures that those levels will be 'just' or 'reasonable'. That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statue. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates . . . when it is in fact doing no such thing."

As we established in the preceeding section, the regulations do in fact exempt small producers from rate regulation. The indirect regulation argument is therefore an *impact argument*, namely, that the impact on the consumers will not be all that bad, and that, in reality, they will get all the protection that the Act requires. An analysis of the impact of the putative indirect regulation shows, however, that the Court of Appeals was correct in its assessment.

For some unexplained reason the Commission's brief (page 20) states that the issue of indirect regulation was not reached by the Court of Appeals because the Court thought the orders provide for *non*regulation rather than indirect regulation. The Court, however, did consider the indirect regulation argument in Section "B" of Part II (Pet. App. 10a-16a) and rejected the argument *because* such indirect regulation amounts to nonregulation.

Initially the Court noted that a type of indirect regulation might be acceptable which provides that small producer rates could be passed on only if such rates themselves were just and reasonable. But the Commission has not done this; and, even if it did, the Court noted that there still might be some valid

objection due to unfair prejudice against the large producer and pipeline purchasers.[44]

The Commission's proposed standard would prohibit pass-through of new small producer rates if they are:

> "* * * unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area.* * *"[45]

This standard has no relation to the "just and reasonable" standard. Large producers can and do contract to sell interstate gas at prices which exceed the area rates and which in fact have no inherent relation to the just and reasonable rates fixed by the Commission. Likewise, rates for intrastate sales are traditionally higher than the Commission's area rates for interstate sales. The orders proscribe pass-through of small producer rates only if they are "unreasonably high" when compared with rates which are themselves unjust and unreasonable. This is not regulation by the just and reasonable standard. Rather such a standard dismisses as irrelevant all the just and reasonable determinations the Commission *has* made. As the Court of Appeals correctly characterized it (Pet. App. 16a), this amounts to *non*-regulation.

In a different section of its brief the Commission does attempt to rehabilitate its indirect regulation argument. It contends (Brief, pages 16-18) that the Court of Appeals misread the orders as saying that the only standards are the highest large producer contract prices or the prevailing intrastate price when the Commission itself said (App. 142) that these are only two factors and that the Commission will consider all relevant factors. But the promise is hollow.

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[44]Pet. App. 10a-11a, n. 17.

[45]App. 142.

What else will the Commission consider? The Commission's brief explains it this way (pages 17-18; emphasis in the original):

> "The order was thus designed to put producers and pipelines on notice that in the context of small producer rate increases, the field prices *would* be considered along with the traditional elements of a rate-base formula. * * *"

Thus it would appear from argument of counsel that small producer costs will also be considered. But how wide is the range of reasonableness within which the Commission must determine just and reasonable rates? And *how* is the Commission ever going to determine what a given small producer's costs are when it has determined not to impose the burden of such proceedings on small producers? On the other hand, if the Commission is going to determine small producer costs, why can it not make a specific determination of just and reasonable rates for small producers? The order itself indicates that the argument of counsel lacks merit. For example in contradistinction to any idea of "traditional elements of a rate base formula" is the Commission's language from Order 428-B (App. 246):

> "* * * The standard * * * provides pipelines with a more concrete guide for their future actions than would exist in the absence thereof. Simply put, the Commission wanted the pipelines to know in advance the boundaries within which they could freely contract with small producers."

The language is obviously designed to reassure the pipelines that if they do not exceed the two enunciated non-statutory standards, if they stay within the "boundaries," they do not have to worry about any other "relevant factors," *i.e.*, they can "freely contract with small producers." As the Court below observed, "* * * It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-

statutory standards" (Pet. App. 14a).

The lack of clarity in the announced Commission standards is indicative of the absence of genuine regulation.

Even more indicative is that the announced standards apply *only* to *new* contracts. There are no standards at all to be applied to contracts entered into before Order 428.[46] Thus some of the very same contracts which were found unjust and unreasonable by the area rate orders issued before Order 428 are now freed from that determintion. What could not be charged before Order 428 can now be passed on to the consumer without any reduction or refund exposure. This is not regulation, nor even *non*regulation. It is complete abdication. It can hardly pretend to meet the statutory just and reasonable standard.

The Commission, by allowing the initiation of *new* sales at above-ceiling rates under blanket certificates, has also set aside another instrument of regulation. Under the *Permian* small producer regulations, as we have mentioned, a small producer could initiate new sales without the scrutiny that accompanies a certificate application but only as long as his rates were within the just and reasonable ceiling rates set by the Commission. Under the new regulations, however, new sales can be initiated anywhere, at any rate, without any Commission scrutiny.

This must be contrasted with the caution that was enjoined upon the Commission in the CATCO decision where this Court required the Commission to give "most careful scrutiny and responsible reaction" to initial rates of producers and, where necessary, to reduce those rates by certificate condition so "that the consuming public may be protected while the justness and reasonableness of the price fixed by the parties is being determined under other sections of the act."[47]

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[46] App. 246, n. 5.

[47] Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 392 (1959).

Perhaps in awareness of this responsibility, the Commission said it would review the rates for new small producer sales in certificate or rate proceedings involving the pipeline. Thus, it explained (App. 139):

> "* * * Any question as to the propriety of the price paid by a pipeline to a small producer will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified. The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent. * * *"[48]

As to such review in pipeline *certificate* cases, the Commission well knows that in most situations new supplies of gas are connected by pipelines under annual blanket budget-type *facility* certificates.[49] The pipeline is not required to obtain a certificate for the *purchase* of gas, but only for the construction of jurisdictional facilities necessary for such purchase (Section 7). Routine, minor connecting facilities necessary to pick up a new package of small producer gas normally would be built by a pipeline under a pre-granted budget-type certificate since no new pipeline sale would be involved, and the Regulations merely require pieplines to report constructed budget-type facilities "within sixty days after expiration of the authorized [12-month] construction period."[50] Furthermore, review of the small producer *rate* in the pipeline's *facility* certificate docket may be improper, and any Commission action would be prospective at best.

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[48]See also the Commission's elaboration of this point in Order No. 428-B (App. 245).

[49]Regulations under the Natural Gas Act §157.7(b), 18 C.F.R. Ch. I, Subchapter E, §157.7(b).

[50]Regulations, §157.7(b)(3), 18 C.F.R. Ch. I, Subchapter E, §157.7(b)(3).

This is hardly the equivalent of the regulation required by Section 7 of the Natural Gas Act. Even if the Commission should at a later date determine to take a closer look at some of the rates initiated under the blanket certificate, it still can do no more than "regulate" "indirectly" under the ephemeral standards we have already examined and could act only prospectively. The Commission thus would be playing catch-up at best. This too marks a decided shortfall from the regulatory standard.

In view then of the manifold deficiencies presented by these orders, it can only be said that the Commission's promise of indirect regulation amounts to a promise, maybe, to regulate someone, some day, under some standard, if the Commission feels like it. Such indirect regulation is a mockery of the active, continuous, all-encompassing regulatory scrutiny *mandated* by the Act. It requires that the orders be set aside.

## III.

## THE ORDERS ILLEGALLY SHIFT THE BURDEN OF REGULATION AND THE BURDEN OF REGULATING TO LARGE PRODUCERS AND PIPELINES

It is quite clear, first, that the orders shift the burden of regulation from the small producers to their purchasers. The small producers will be free to collect revenues at the contract rate (App. 149) without any refund obligation (App. 142) while their large producer and pipeline purchasers' rates will be subject to reduction and refund according to the so-called "unreasonably high" standard (*ibid.*). Thus the purchaser would have to absorb the difference between the small producer's contract rate and whatever rate the Commission might find not unreasonably high. As we have already shown, large producers and pipelines are provided no definitive standards by which to determine whether the purchase price will be viewed favorably by the Commission, yet it is apparent that the Commission expects the large producers and pipelines at their peril to effectuate the purpose of the Commission's orders in their purchases from small producers.

Nothing in the Act authorizes the Commission to require one class of regulated companies to insulate another, preferred, class of regulated companies from the effects of regulation or to absorb the regulatory burden that should rightfully be imposed upon the preferred class. Any attempt to do so constitutes confiscation and denial of due process of the clearest kind. That the Commission even professes the intent to regulate by such indirection establishes the invalidity of the Commission's orders.

The Commission argues that its method merely applies the old rule that regulated companies may include in their cost of service only those costs which are reasonable (App. 245). But such an assertion ignores the mandate of Sections 4 and 5 of the Act that all rates charged must be just and reasonable. As consumers themselves, large producers and pipelines have a right to expect to pay only just and reasonable rates for the gas they buy. Moreover, the assertion ignores the refund provision of Section 4 which is the statutory means of assuring that *every* natural-gas company shall carry its own share of the regulatory burdens. Since the orders eliminate the small producers' obligation to make refunds of rates subsequently found to be unjust or unreasonable, they plainly impose very different risks on such regulated purchasers from those that previously existed.

The orders also erroneously shift the burden of *regulating* from the Commission to large producers and pipelines which purchase gas from small producers, for it is apparent that the Commission has abdicated *its* responsibility to fix rates for small producer sales in the public interest and has instead required the large producer and pipeline purchaser to do so through contract negotiations. Such a shift not only ignores the statute which imposes the regulating responsibility on the Commission, but it also places an impossible burden on such purchasers.

The large producer and pipeline purchasers are not regulators. They are, obviously, part of the regulated industry whose functions are to find, sell, transport, and deliver natural gas to purchasers for ultimate public consumption. And while such purchasers are enjoined by the Act from charging rates which are unjust and unreasonable, the Act requires the *Commission*

to determine whether or not such rates are just and reasonable and, if not, to prescribe rates which are. Unless and until Congress determines that all producer rates are to be established by market forces alone, this division of responsibilities clearly shows a Congressional conviction that the expertise to determine and fix such rates in the public interest is in the regulatory body.

The intent of Congress in this regard is understandable. For instance, when certain kinds of costs *are* to be passed on to consumers through the rates to be charged by a natural gas company, the standard of reasonableness is usually one of managerial prudence and discretion. On the other hand, there are major policy decisions in ratemaking which must, of their nature, be made by regulatory bodies—decisions where the issue is *whether* a certain cost or a certain kind of cost is proper to be passed on to the consumers as a matter of regulatory policy. The reasonableness of management in incurring the cost is not at issue. It is this type of decisions which must be made by a regulatory body and which cannot be made by management.[51]

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[51] As an example, on November 1, 1973, the Commission issued its Opinion No. 672 in Texas Eastern Transmission Corporation, Docket Nos. RP70-29, et al., disallowing costs associated with some $9,000,000 of advance payments. The pipeline had made the advance payments in the exploration and development of gas reserves in the Sable Island area of offshore Nova Scotia. The Commission disallowed these because, inter alia, the pipeline had "failed to show that the advance payment arrangement is reasonable in view of the extended period of time during which the rate-payers would be required to pay return and taxes ... before sufficient gas reserves could be found to make the venture feasible * * *" (pp. 5-6). It also expressed doubt that the Canadian gas could ever benefit U.S. consumers (p. 9).

The Commission has also proscribed certain *types* of contract provisions where there was no question that they met the standard of managerial prudence and discretion but there were other serious public interest objections, e.g., "indefinite" escalation provisions [see Order No. 232A, Docket No. R-153, 25 FPC 609 (1961); Order No. 242, Docket No. R-203, 27

While the large producer or pipeline can negotiate the best possible price with a small producer under market conditions existing at the time, there is no way that it can go behind that price to examine the small producer's costs or other factors which might be relevant and material in a just and reasonable rate determination. Such a purchaser has no power of discovery or other regulatory tools at its disposal even if it had the expertise. Such an impossible burden, the burden of regulating, cannot and therefore may not lawfully be shifted to the large producers and pipelines. The orders accordingly must fall.

## IV.

## THE ORDERS DISCRIMINATE UNFAIRLY AGAINST LARGE PRODUCERS

The Orders under review have been, for some unstated reason, carefully contrived to squeeze large producers. The beneficiaries are the small producers and pipelines as we shall show.

### A. The Orders unfairly discriminate against large producers in favor of small producers.

1. **Large producer plant operators.** The Orders effectively shift dollars from plant operators to small producers. Large producer plant owners will be forced to pay more for some small producer gas than they can collect for reselling it. Orders 428 and 428-B restore full effect to numerous contracts between plant operators, like Phillips, and small producers, but they do not permit the plant operators to pass on such increases unless their resale contracts permit such increases (App. 150). Hence, the large producer plant operator must now absorb increased costs for gas purchased from small producers.

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FPC 339 (1962), affirmed, Federal Power Commission v. Texaco Inc., 377 U.S. 33 (1964)] and "excessive" take-or-pay provisions [see El Paso Natural Gas Company, Opinion No. 390, 29 FPC 1175, 1185 (1963); Michigan Wisconsin Pipe Line Company, Opinion No. 353, 27 FPC 449, 454-57, 463 (1962); Panhandle Eastern Pipe Line Company, Opinion No. 350, 27 FPC 35, 46, 51 (1962)].

Plant operators like Phillips object to the Orders because they fail to recognize that the industry has been built up under a system where *all* jurisdictional wellhead sales of gas, and jurisdictional sales of residue gas at plant outlets have been regulated by the Commission. As a result of the first *Phillips* decision the processing industry was subjected to regulation under the Act insofar as its residue gas prices were concerned, and resale contracts with pipelines were thereafter negotiated within that regulatory framework. More recently, under the area rate method, the Commission applied area ceilings to sales at the plant outlet and to gas acquired by plant operators at the wellhead, including small producer gas.

Processing plant operations have accordingly been built upon a *spread* or differential between aggregate gas costs and aggregate residue gas revenues. Now, however, the Commission has decided to deregulate the spread insofar as small producer wellhead rates are concerned. *Half* of the regulatory framework is suddenly blown away with the result that small producers are enriched at the expense of the large producer plant operators. In the name of administrative convenience, the Commission has shifted substantial dollars from one party to another without any finding that the small producers need such excess revenues generated from their rates and without any evidence to support such a finding if one was intended. The commission has seriously distorted the economic balance and competitive factors within the industry without visible recognition of its statutory obligation to maintain a healthy industry structure.[52]

The Commission, claiming that the *Sierra* doctrine[53] requires adherence to the contract price, rejected Phillips' request that a plant operator be allowed to pass through the customary differential between its gas costs and the resale price of residue

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[52]See Southern Louisiana Area Rate Cases, 428 F.2d 407, 442 (5th Cir. 1970) certiorari denied 400 U.S. 950.

[53]Federal Power Commission v. Sierra Pacific Power Company, 350 U.S. 348 (1956).

gas regardless of the price specified in the resale contract. We contend that the Commission erroneously construed *Sierra* and that its refusal to grant the relief requested was arbitrary, capricious and unduly discriminatory.

Here, where the aggrievement is caused by Commission action, it is error for the Commission to relay on *Sierra* in denying relief to plant operators. In *Sierra*, the Commission had allowed a regulated company to increase its rate to Sierra unilaterally although the contract provided for the old, lower rate. The Court held that neither the unilateral filing nor the Commission's finding that the new rate was not unlawful was effective to change the contract with Sierra. 350 U.S. at 353. Here there is no unilateral increase being proposed by the plant operators but, rather, an attempt to recoup cost increases resulting from the Commission's abrupt reversal of established regulatory policy.

The Commission has the power to grant the relief requested and it should have done so here. *Sierra* leaves no doubt as to that power:

> "* * * The Commission has undoubted power . . . to prescribe a change in contract rates whenever it determines such rates to be unlawful. * * * [T]he Commission's order here, if based on the necessary findings, could have been effective to prescribe the proposed rate as the rate to be in effect prospectively from the date of the order, June 17, 1954. * * *
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>
> "The condition precedent to the Commission's exercise of its power . . . is a finding that the existing rate is 'unjust, unreasonable, unduly discriminatory or preferential.' * * *" (350 U.S. at 353).

We contend that it was unduly discriminatory and preferential, arbitrary, capricious, and an abuse of administrative discretion for the Commission to adopt a policy which shifts costs to plant operators but refuses to allow a pass on of those costs. The extreme unfairness of the Commission's action can be seen in the context of minimum rates: in its area rate

method of fixing just and reasonable rates the Commission, relying on *Sierra*, has fixed just and reasonable minimum rates and declared that such minimums may be charged by the seller even though he voluntarily agreed to a lower contract rate.[54] In the orders here, the Commission expressly provided that small producers could charge the "minimum rate authorized by the Commission for any area" (App. 144 n. 5)—*i.e.*, the small producer may exceed his contract price. But the plant operator may not exceed *its* resale contract price to pass along the Commission-imposed increase in costs.

We submit that if the impact of small producer sales is so insignificant that considerations of administrative convenience warrant the exemption of such sales from regulation, then the public should bear the "insignificant" cost increases. If, on the other hand, small producer sales are significant, affecting the rates "of millions of American consumers" as the Commission found in *Permian, supra,* then they should not be exempted. But in niether case is the Commission justified in practicing the unlawful discrimination which shifts dollars from the plant operators' pockets into the pockets of small producers without findings or evidence to support such a result. We contend that the Act does not permit such basic disruption of the regulated industry without the most compelling evidence of the absolute necessity for such disruption.

2. **Large producers selling gas at the wellhead.** Large producers selling gas at the wellhead are unfairly discriminated

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[54] 34 FPC at 231-32, affirmed 390 U.S. at 821. Of course, in those cases the Commission was also fixing resale rates of plant operators, and it had a complete evidentiary record and findings.

against in favor of small producers. Small producer sales are "authorized" under the blanket certificate provided for in Order No. 428. No administrative delay is involved once the small producer receives his blanket certificate; hence new sales can be commenced immediately. Large producers, on the other hand, must obtain a separate certificate for each new sale, and there are weeks of delay involved in preparing and filing applications and obtaining authorization. The unfairness of this emerges sharply in the situation where both the small producer and large producer own interests in the same gas reservoir. The small producer can commence selling gas immediately, but the large producer is forced to suffer drainage while awaiting certificate authorization.

The problem is not regulatory delay, *per se*, but delay to some producers who are forced to comply with the Act, and no delay to other (small) producers who are not required to comply. Delay to some because the Regulations implement the Act, and no delay to others because the Regulations exempt that class from the Act's requirements. We say that the Commission may not thus discriminate and force large producers to suffer the loss of their property without compensation.

**B. The Orders unfairly discriminate against large producers in favor of pipelines.**

1. **Rate increases and refunds.** Pipelines are allowed by Orders 428 and 428-B to pass through without any refund obligation the increased costs of small producer purchases under contracts dated before March 18, 1971. All small producer increases in rates above the just and reasonable area ceiling rates will be passed on by the pipelines without any Commission scrutiny of the appropriateness of the rates.

For the large producers, it is a different story. We have already noted how large producer plant operators are limited in their tracking rights to rates specified in their contracts. Additionally, the generality of the wording of the orders would allow the Commission to suspend a producer plant operator's contractually permissible increase and allow its collection subject to refund under the amorphous standards of its regulation:

"* * * Any such [large producer plant operator] rate filing shall be accepted if the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area, and if the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market prices for interstate sales in the same producing area." (App. 150).

This price differential test for producer plant operators applies to both old and new contracts.

There is no basis for thus imposing on large producers the jeopardy with respect to old contracts which was specifically lifted from pipelines. And as usual, the Commission has offered no such basis. The orders must therefore be set aside.

2. **Competition for new gas.** The orders also discriminate in favor of pipelines and against large producer plant operators in the competition for new gas. Both large producer plant operators and pipelines will be competing for new small producer gas. It often happens that a pipeline buys unprocessed gas at the wellhead and will compete with a producer-plant for the very same small producer's gas.

Under the Commission's new regulations, pipelines will have substantial competitive advantages. First, pipelines will be able to contract for this new gas at any price: they will be able to collect such rates, perhaps subject to refund, but always with the opportunity to show that the rates are not "unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." (App. 142). Furthermore, even if a given price should not come within this framework, it could still be offered by a pipeline if the volumes were substantial enough, or if the pipeline were gas hungry enough, so that the pipeline could risk suspension and possible refund.

Second, the orders discourage percentage-of-the-proceeds sales to large producers. Such sales typically provide for payment by the processing plant to the wellhead seller (*e.g.*, the small producer) of a percentage of revenues derived from the resale of gas stream components. No small producer is going to sell to a large producer who is locked into a resale contract price when it could get the higher intrastate price from an interstate pipeline.

Further, pipelines have the ability to connect new supplies immediately under budget-type certificates. Large producer plant operators, on the other hand, are effectively precluded from connecting new supplies to be sold under new resale contracts until they have filed a certificate application (App. 253). In light of the highly competitive nature of the industry, it was unduly discriminatory and an abuse of discretion for the Commission to deny plant operators the same freedom from administrative delay which is enjoyed by pieplines.

For all of the above reasons the Orders unfairly discriminate against large producers. In some cases the balance is in favor of the small producers, in other cases in favor of the pipelines: but always against the large producer. This is not permitted by Section 4(a) of the Act which forbids the Commission itself as well as the companies regulated by it to "... make or grant any undue preference or advantages to any person or subject any person to any undue prejudice or disadvantage. ..."

## CONCLUSION

For the foregoing reasons, Phillips submits that the opinion and judgement of the Court of Appeals should be affirmed.

Respectfully submitted,

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The Natural Gas Act, 15 U.S.C. §§ 717, *et seq.*, provides in pertinent part:

*Section 1.* (a) As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest. [52 Stat. 821 (1938); 15 U.S.C. § 717 (a)]

(b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas. [52 Stat. 821 (1938); 15 U.S.C. § 717 (b)]

(c)[1/] The provisions of this Act shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the bounday of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this Act by this subsection are

[1] Subsection (c) was added March 27, 1954, by Public Law No. 323, 83d Congress, chapter 115, 2d session [H. R. 5976] 68 Stat. 36.

hereby declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction. [68 Stat. 36 (1954); 15 U.S.C. § 717 (c)]

*Section 2.* When used in this act, unless the context otherwise requires–

(1) "Person" includes an individual or a corporation.

(2) "Corporation" includes any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, receiver or receivers, trustee or trustees of any of the foregoing, but shall not include municipalities as hereinafter defined.

(3) "Municipality" means a city, county, or other political subdivision or agency of a State.

(4) "State" means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

(5) "Natural gas" means either natural gas unmixed, or any mixture of natural and artifical gas.

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

(8) "State commission" means the regulatory body of the State or municipality having jurisdiction to regulate rates and charges for the sale of natural gas to consumers within the State or municipality.

(9) "Commission" and "Commissioner" means the Federal Power Commission, and a member thereof, respectively. [52 Stat. 821 (1938); 15 U.S.C. § 717a]

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## RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

*Section 4.* (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for

good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company[2] or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect;[2] and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with

[2]Subsection 4 (e) was amended May 21, 1962 by Public Law 87-454, 87th Congress, 2d Session [S. 1595], 76 Stat. 72.

interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 76 Stat. 72 (1962); 15 U.S.C.§ 717c]

## FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

*Section 5.* (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or trans-

portation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas. [52 Stat. 823 (1938); 15 U.S.C. § 717d]

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## EXTENSION OF FACILITIES; ABANDONMENT OF SERVICE

*Section 7.* (a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers. [52 Stat. 824 (1938); 15 U.S.C. § 717f (a)]

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment. [52 Stat. 824 (1938); 15 U.S.C. § 717f (b)]

(c)[3] No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations; *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application

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[3] Subsection 7 (c) amended; (d), (e), (f) and (g) added February 7, 1942 by Public Law No. 444, 77th Congress, Chapter 49, 2d session [H. R. 5249], 56 Stat. 83, 84.

for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [52 Stat. 825 (1938), as amended, 56 Stat. 83 (1942); 15 U.S.C. § 717f (c)]

(d)[4/] Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require. [56 Stat. 84 (1942); 15 U.S.C. § 717f (d)]

(e)[5/] Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. [56 Stat. 84 (1942); 15 U.S.C. § 717f (e)]

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4, 5. See footnote 2, supra.

(f)[6] The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization. [56 Stat. 84 (1942); 15 U.S.C. § 717f (f)]

(g)[7] Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural-gas company. [56 Stat. 84 (1942); 15 U.S.C. § 717f (g)]

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## ADMINISTRATION POWERS OF COMMISSION; RULES, REGULATIONS, AND ORDERS

*Section 16.* The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the

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[6] See footnote 2, supra

[7] See footnote 3, supra

Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours. [52 Stat. 830 (1938); 15 U.S.C. § 717o]

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## REHEARING; COURT REVIEW OF ORDERS

*Sec. 19* (a)[8] Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b), the Commission may at any time, upon reasonable notice and in

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[8]The Act of August 28, 1958 (72 Stat. 941 at 947) added the last sentence to subsection (a) and, in the second sentence of subsection (b), substituted "Transmitted by the clerk of the court to" for "served upon", substituted "file with the court" for "certify and file with the court a transcript of" inserted "as provided in section 2112 of title 28, United States Code", and, in the third sentence, substituted "jurisdiction, which upon the filing of the record with it shall be exclusive" for "exclusive jurisdiction".

such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this Act.

(b)[8] Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States [9] for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any

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[8]The Act of August 28, 1958 (72 Stat. 941 at 947) added the last sentence to subsection (a) and, in the second sentence of subsection (b), substituted "Transmitted by the clerk of the court to" for "served upon", substituted "file with the court" for "certify and file with the court a transcript of" inserted "as provided in section 2112 of title 28, United States Code", and, in the third sentence, substituted "jurisdiction, which upon the filing of the record with it shall be exclusive" for "exclusive jurisdiction".

[9] Circuit Court of Appeals of the United States was redesignated as "United States Court of Appeals" by Act of June 25, 1948, 62 Stat. 870.

party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, sec. 1254). [52 Stat. 831 (1938); 15 U.S.C. § 717r]

* * * * *

The Federal Power Commission's Regulations under the Natural Gas Act, 18 C.F.R. Ch. I, Subchapter E, provide in pertinent part:

*Section 157.7 Abbreviated applications.*

*(a) General.* When the operations, sales, service, construction, extensions, acquisitions or abandonment proposed by an application do not require all the data and information specified by this part to disclose fully the nature and extent of the proposed undertaking, an abbreviated application may be filed provided it contains all information and supporting data necessary to explain fully the proposed project, its economic justification, its effect upon applicant's present and future operations and upon the public proposed to be served, and is otherwise in conformity with the applicable requirements of this part regarding form, manner of presentation, and filing. Such an application shall (1) state that it is an abbreviated application; (2) specify which of the data and information required by this part are omitted; and (3) relate the facts relied upon to justify separately each such omission.

*(b) Gas-purchase facilities–budget-type applications.* An abbreviated application requesting a budget-type certificate authorizing the construction of gas-purchase facilities during a given twelve-month period and operation thereafter may be filed when:

(1) (i) The total estimated cost of the gas purchase facilities proposed in the application does not exceed 2 percent of the applicant's gas plant (Account 101 Uniform System of Accounts Prescribed for Natural Gas Companies) or $7 million whichever is lesser, except that an applicant with less than $5 million in such gas plant account may have a total gas purchase budget amount of $100,000.

(ii) The cost of gas-purchase facilities for any single project to be installed during the authorized construction period does not exceed 25 percent of the total budget amount or $1 million, whichever is the lesser, except that a single offshore project, including any in the disputed zone, is limited only to

25 percent of the total budget amount.

(2) Any application proposing the construction of facilities having an estimated total cost in excess of the amounts specified in subparagraph (1) of this paragraph shall be accompanied by a request for waiver of the provisions of such paragraph and will be granted only for good cause shown.

(3) The applicant agrees to file with the Commission, within sixty days after expiration of the authorized construction period, a statement showing for each individual project:

(i) Description of the gas-purchase facilities installed, e.g., miles and size of pipelines, compressor horsepower, metering facilities.

(ii) Location of gas-purchase facilities installed.

(iii) Actual installed cost of gas-purchase facilities subdivided by size of pipelines, compressor horsepower, metering facilities and appurtenant facilities.

(iv) Estimated recoverable gas reserves in Mcf at 14.73 psia made available to applicant by means of the facilities last installed.

(v) Names of fields connected.

(vi) The names of the independent producers or other sellers from whom the gas is being purchased together with the respective dates of their gas sales contracts, FPC gas rate schedule designations, and related certificate docket numbers.

(4) "Gas-purchase facilities" means those facilities, subject to the jurisdiction of the Commission, necessary to connect applicant's system with the facilities of an independent producer or other similar seller authorized by this Commission to make a sale to the applicant for resale in interstate commerce.

(c) *Gas-sales or transportation facilities - budget type application.* An abbreviated application requesting a budget-type certificate authorizing the construction during a given twelve-month period, and operation of gas-sales or transportation facilities may be filed when:

(1) The facilities proposed in the application are to be used for any of the following purposes:

(i) The transportation and sale of volumes of natural gas previously authorized under certificates for transportation or sale to existing distributors at rates on file with this Commission, for resale in existing market areas, if such distributors have obtained all requisite local and state authorization. An abbreviated application may not be filed pursuant to this section if the distributor is to be required to make a contribution to the applicant for the cost of construction of the facilities or if the distributor is served or is proposed to be served by more than one natural gas company;

* * * * *

(3) (i) The total estimated cost of the gas-sales or transportation facilities proposed in the application does not exceed $300,000 except where the applicant's gas plant (Account No. 101, Uniform System of Accounts Prescribed for Natural Gas Companies) is $10,000,000 or less, in which case the total estimated cost of the gas-sales facilities proposed in the application shall not exceed $100,000.

(ii) Any application proposing the construction of facilities having an estimated cost in excess of the amounts specified in subdivision (i) of this subparagraph shall be accompanied by a request for waiver of the provisions of such subdivision and will be granted only for good cause shown.

(4) The application contains a statement showing the minimum rate, i.e., price per Mcf, at which the applicant proposes to make direct industrial sales.

(5) The application contains a statement indicating the maximum facilities to be installed during the authorized construction period subdivided by type of project, e.g., new delivery points for distributors, direct sales to ultimate consumers and miscellaneous rearrangements, and describing the maximum number of lateral or loop lines to be installed and their maximum length and diameter, the maximum number of taps and meters to be installed, and the estimated cost of facilities for each such type or project.

* * * * *

(7) The applicant agrees that any certificate issued pur
to an application filed under this paragraph (c) shall be
to the following conditions:

* * * * *

(8) The applicant agrees to file with the Commission,
in sixty days after expiration of the authorized constr
period, a statement showing for each individual project:

(i) Description of the gas-sales or transportation fa
installed, e.g., miles and size of pipeline (including wall
ness and minimum yield point), taps, laterals, lateral loop
metering and regulating facilities.

(ii) Location of gas-sales or transportation faciliti
stalled and new delivery points established.

(iii) Actual installed cost of gas-sales or transport
facilities subdivided by size of pipline, taps, laterals, lateral
lines, metering and regulating facilities, and appurt
facilities.

(iv) Name of distributor or direct industrial con
served and type of service (firm or interruptible) to be rend

(v) Estimated annual and peak-day deliveries and estim
annual revenues for each of the first 3 years of natural
service, designating which service is under FPC rate sched

(vi) Ultimate use of the gas.

(9) "Boiler fuel purposes," as used herein, means the u
natural gas in boilers for the generation of steam for ele
power generation. "Distributors" means persons, municipal
and other public agencies engaged in the local distributio
natural gas to the public.

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In The

# Supreme Court of the United States

October Term, 1972

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No. 72-1490

Federal Power Commission

v.

Texaco, Inc., et al.

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No. 72-1491

Dudley T. Dougherty, et al., Co-Executors of the Estate of Mrs. James R. Dougherty, et al.

v.

Texaco, Inc., et al.

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**On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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**BRIEF FOR THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, RESPONDENT**

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## OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-22a)[1] is reported at 474 F.2d 416. The initial order (No. 428) of the Federal Power Commission (App. 135-154), its order (No. 428-A) of amendment (App. 159-161), and its order (No. 428-B) denying rehearing (App. 238-253) are reported at 45 F.P.C. 454, 45 F.P.C. 548, and 46 F.P.C. 47, respectively.

## JURISDICTION

The judgment of the court of appeals (Pet. App. 23a-25a) was entered on December 12, 1972, and the Commission's petition for rehearing was denied on February 5, 1973 (Pet. App. 26a-28a). The petitions for writs of certiorari were filed on May 3, 1973, and granted on October 9, 1973 (App. 254). The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTIONS PRESENTED

1. Whether the Federal Power Commission acted properly under the Natural Gas Act in freeing all new sales of small producers from any rate regulation as long as their rates are consistent with the highest *contract* rates of large producers or the prevailing rate for gas in the unregulated *intrastate* market?

2. Whether the Commission may regulate the rates for new sales by small producers indirectly through rate proceedings involving the pipeline and large producer purchasers of their gas, while freeing the small producers

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[1] Citations in this brief to "Pet. App." refer to the Appendix to the Petition for Writ of Certiorari in Case No. 72-1490, and citations to "App." refer to the printed brown Appendix in the consolidated proceeding.

rom all refund or rate reduction obligations as a result f such proceedings.

3. Whether there is any justification for the absolute leregulation of all existing sales of gas by small producers.

## STATUTES INVOLVED

The relevant portions of the *Natural Gas Act*, 15 U.S.C. 717 *et seq.* are set forth in the Appendix to the brief filed by the Federal Power Commission in No. 72-1490.

## STATEMENT

This case is before the Court to review a decision of the Court of Appeals for the District of Columbia Circuit (Pet. App. 1a-22a) setting aside orders of the Federal Power Commission which freed sales by "small producers" in interstate commerce for resale from any rate regulation under the Natural Gas Act, but purported to control the rate level of new sales by small producers when the pipeline or large producer purchasers of the gas seek to pass the increased costs on to their customers. The Court of Appeals held that the Commission's plan for the indirect regulation of the small producers rates was based upon unregulated market standards having no relation to the just and reasonable test imposed by the Natural Gas Act and was thus unlawful.

The Public Service Commission of the State of New York (New York) is a regulatory agency established under the laws of that state to protect the interest of New York's citizens in the furnishing of adequate utility service, including natural gas, at reasonable rates. In this capacity it participated fully in the proceeding below before the Federal Power Commission, and was one of the petitioners in the court below.

## The Nature of the Problem

Ever since it was definitely established in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954) that sales of gas in interstate commerce for resale by independent producers were subject to the rate and certificate provisions of the Natural Gas Act, questions have been raised as to the appropriate procedures for regulating the numerous small producers who make up the great bulk of the entities involved in the production and sale of natural gas but account for a relatively small portion of the total volumes of gas, or purchased gas costs of the interstate pipelines. The Natural Gas Act, in unambiguous terms, states that its rate making standards and provisions apply to "all rates and charges" by "any natural gas company" with respect to jurisdictional sales, and that "any such rate or charge that is not just and reasonable is hereby declared to be unlawful" (see Section 4(a)). Similarly, the certificate provisions of Section 7 preclude any jurisdictional sales unless a certificate of public convenience or necessity has been issued therefor. And the only provision in the Act made for relief from these requirements is the proviso to Section 7(c) which authorizes the Commission by regulation to exempt from the Act's certification requirements "temporary acts or operations for which the issuance of a certificate will not be required in the public interest." Since there were and are more than three thousand separate entities engaged in natural gas production and sale for resale in interstate commerce, the problem of how the Commission could manage its responsibilities, and equally important how the administrative expense of regulation pursuant to the statutory standards could avoid imposing a crushing economic burden on the smaller producers, loomed large among the many difficult problems faced by the Commission in formulating effective regulatory procedures for producer regulation.

The problem was peculiarly acute during the eight year period subsequent to *Phillips* when the Commission operated on the assumption that the proper manner of regulating producers was on the individual company basis it had applied in the case of pipelines and electric utilities. Since the first major producer case was not ready for decision until late 1961, the specter of an interminable number of separate but complex proceedings haunted the regulatory effort, with the Commission estimating it would take it well into the twenty first century to dispose of its existing backlog of individual company rate cases. The avoidance of this administrative morass was one of the principal factors that led the Commission in the second *Phillips case*, 24 F.P.C. 537 (1960) to move to area rates as the solution for its producer rate problems.

The Commission's determination to abandon individual producer rule cases and move to area rate proceedings was affirmed in *Wisconsin* v. *Federal Power Commission*, 373 U.S. 294 (1963). In his dissenting opinion there, (373 U.S. at 329-330) Mr. Justice Clark first raised the question of a possible "temporary" exemption of small producers while the Commission concentrated on the rates of the largest individual producers. This, he suggested, might be a more effective approach to the administrative problem than the area rate technique he was convinced would, for other reasons, not provide adequate consumer protection. Subsequently, in *F.P.C.* v. *Hunt*, 376 U.S. 515, 527 (1964), Justice Clark, here speaking for a majority of the Court in a certificate case, suggested that the administrative delay resulting from dealing with all producer sales certificate applications on an individual basis, which, it was alleged "transposes, for all practical matters, temporary certificates into permanent ones," might be avoided if the Commission found itself in a position to utilize exemption practices similar to those then followed by the National Labor Relations Board.

In the *Permian Basin Area Rate Case*, 34 F.P.C. 159 (1965), the first of the area proceedings, the Commission came to grips with the problem of the small producers. It did so on the basis of a record which was most ambiguous as to the extent to which, if any, the unit costs of such small producers were higher than those of the producers as a whole.[2] The Commission concluded, however, (34 F.P.C. at 234-35) that special treatment for small producers which would ease the burdens of regulation without the risk of substantial impact on consumer prices would be in the public interest. But it also determined (*Ibid.*) an outright exemption of small producers, assuming it was legally permissible, was neither "necessary or desirable."

In reaching this determination the Commission found a "basic consideration" to be that "the impact of small producer prices on consumers is by no means *de minimus* and is of great impact in some instances" (34 F.P.C. at 235). Though the small producers represented, the Commission, found only 15% of the aggregate interstate gas supply, the range insofar as individual pipelines was concerned was very great and "it is obvious they are a

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[2] The Commission in *Permian* had provided two cost questionnaires, the so-called Appendix B questionnaire, mandatory for large producers but voluntary for small ones, and a special Appendix C, less detailed than that required for the large producers, which the other small producers were asked to fill out. The limited number of actual responses to Appendix C showed average unit costs of approximately 2 cents per mcf higher than that shown by the larger producers. But the eighteen small producers who responded to the more detailed Appendix B showed lower costs on the average than the larger producers. And many of the smaller producers did not answer at all, or provided meaningless data. Thus the only conclusion the Examiner could make was that "on a per mcf basis, the small producers had relatively larger dry hole expenses, a smaller proportion of geological and geophysical expenses, and a smaller proportion of lease acquisition expenditures. On a unit basis smaller producers had a relatively larger DD&A expense than the larger producers" (34 F.P.C. at 361).

substantial factor in the cost of gas supply of millions of American consumers" (*Ibid.*). Also, the Commission found, the penetration of the rate ceilings which would result from an absolute exemption, even if on a small scale, could be "seriously disruptive of a pattern of uniform area rates" (*Ibid.*).

While making the area just and reasonable rates applicable to all producers, small and large alike, the Commission in *Permian* initiated action, consummated by Order 308 issued on November 5, 1965 to relieve small producers of virtually all of the administrative burdens and costs of both the rate and certificate provisions of the Natural Gas Act. *Rate and Certificate Filings by Small Independent Producers*, 34 F.P.C. 1202 (1965). This action took the form of the establishment of a program for the issuance of "Small Producer Certificates" available to any producer with jurisdictional sales of less than 10,000,000 mcf of gas per year, under which the producer would be able to make all of its existing sales and any new ones without seeking further authorization from the Commission as long as his total annual sales did not exceed the prescribed minimum, and any price authorized by his contract with the purchaser did not exceed the applicable just and reasonable ceilings for such gas in the particular area. While Order 308 was originally applicable only to the Permian Basin, the rule expressly contemplated that the coverage of the small producer certificates would be expanded to cover sales from the other production areas as just and reasonable prices were established for those areas. And in fact, as of the time of the instant proceeding, the small producer certificate program had already been expanded to cover the Hugoton-Anadarko, Southern Louisiana, Appalachian Basin and Illinois Basin areas, with the only remaining major areas being the Texas Gulf Coast, Other South-

west and Rocky Mountain areas in which rate proceedings were then still pending.

In addition, the Commission in its *Permian* decision gave small producers the option of being relieved from the requirements it imposed on large producers with respect to rate adjustments as a result of abnormal quality conditions (see 34 F.P.C. at 225).[3] This exception to the general area rate was justified by the Commission on the grounds of its *de minimus* effect on the overall gas costs and the fact that the costs of determining the necessary quality adjustments for the many small producers would be greater than the total amount of adjustment.

In its decision affirming the Commission's *Permian Basin* opinions the Supreme Court expressly affirmed the Commission's treatment of small producers. Specifically, it found that the Commission had a proper factual basis in the record for classifying small producers separately for purposes of its regulation and that the "carefully selected special arrangements for small producers" which the Commision had found "would not improperly increase consumer prices" were "fully consistent with the terms and purposes of [the Commission's] statutory responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 787 (1968). Similar arrangements for ameliorating the Commission's administrative difficulties, the Court added, had been suggested by it in the *Hunt* case, *supra*. The Court's opinion, of course, does not hold that the Commission's power to classify small producers for special regulatory treatment authorized it to exempt them from all effective rate regulation; the Commission had rejected this approach and it was not advocated by any

[3] If, however, a small producer chose to avail itself of this option with respect to quality aspects which would have lowered the maximum rate they could charge for their gas, they were not permitted to take advantage of other quality provisions, such as higher than standard BTU content, which served to raise the maximum price.

party in the Supreme Court review of the Commission's decision.

### The Proceedings Before the Commission

The present proceeding was instituted by a Notice of Proposed Rule Making (App. 1-13) issued by the Commission in Docket No. R-393 on July 23, 1970. In this Notice the Commission proposed simply to exempt small producers from all provisions of the Natural Gas Act and the Commission's regulations thereunder, except for the requirement of the existing small producer rule that they file an annual statement setting forth the volume of their jurisdictional sales (App. 2-3).[4]

In justification for its proposed action the Commission suggested that the relief previously granted under the existing Small Producers Certificate program "has been inadequate for small producers since they still bear many of the expenses and burdens of complying with regulatory requirements, particularly when they seek the same treatment accorded large producers. Such relief has also increased the difficulties inherent in processing small producer filings from an administrative viewpoint instead of decreasing these problems as was intended" (App. 2). In addition to this alleged further relief from unspecified administrative burdens, the Commission added, without further explanation, that exempting small producers from compliance with the Natural Gas Act should encourage them to increase their exploratory efforts. At the same time, however, the Commission stated that the impact of the proposed exemption on consumers should be "minimal" since small producers account for a relatively small share of the gas produced nationally and "as

[4] The only exceptions were with respect to "percentage sales" by small producers to other producers (under which they contract to secure a fixed percentage of the large producer's resale price) and sales to interstate pipelines by their affiliates (App. 1).

a practical matter" are not normally in a position to obtain more for their gas than the large producers whose sales are subject to the just and reasonable area rate ceilings (App. 2).

No attempt was made in the Notice at a legal justification for the Commission's action, other than a general reference to Justice Clark's suggestion in the *Hunt* case, *supra*, that the Commission consider the availability of exemption procedures.

Following the issuance of the Notice a large number of comments were filed, many of which opposed the exemption proposal or recommended substantial modification thereof. An informal conference between the members of the Commission staff and all interested parties was held on December 8, 1970, in which many of the objections expressed in the written comments were further detailed (App. 97-134).

On March 18, 1971, the Commission issued its Order 428 in the proceeding (App. 135-154). While this order was entitled as an "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements" it did nothing significant in either respect which had not been accomplished by the earlier Small Producer Certificate procedure established by Order 308 over five years earlier. But the new Order, while no longer purporting to exempt small producers from all rate regulation under the Natural Gas Act, in effect achieved this objective. It did so by relieving the small producer of all necessity for complying with the just and reasonable area rate ceilings which had been adopted for the various production areas or any other maximum price limitations.

This did "not constitute deregulation of sales by small producers" the Commission stated (App. 138) since it would "continue to regulate such sales at the pipeline

[and large producer-purchaser] level by reviewing the purchased gas costs of each pipeline with respect to small producer sales." But the "consumer protection" to be afforded by such review was promptly vitiated by the assurances the Commission gave to the pipeline and large producers that they would be permitted to pass on to their customers all increased costs resulting from any rates they might pay small producers for their gas as long as the rate was not "unreasonably high considering appropriate comparisons with *highest contract* prices for sales by large producers or the prevailing market price for *intrastate* sales in the same production area" (App. 140, 142; emphasis added).

The Commission did, however, limit its deregulation proposal in three respects. First of all, it stated that the abandonment provisions of Section 7(b) of the Act would continue to apply to small producer sales authorized by the blanket certificates (App. 140-141). The Order also provided that the exemption from the area price limitations would not apply to sales by small producers through the purchase of developed reserves in place from a large producer (App. 138). And finally, the Commission continued in effect for small producers the proscription against any *indefinite* price escalation clauses in gas sales contracts of the "favored nation" or "spiral escalation" type which would have the effect of increasing prices above the area just and reasonable ceiling.[5] Such clauses which would increase a small producer's contract price above the just and reasonable area level, the Commission concluded "would clearly be contrary to the public interest" since they would have an "adverse impact on consumers" (App. 138). Why *fixed* escalation clauses in

[5] These clauses had previously been proscribed for all new producer contracts after April 2, 1962, see *F.P.C.* v. *Texaco, Inc.*, 377 U.S. 33 (1964), and made ineffective above the just and reasonable ceiling in all other contracts in the Commission's *Permian* Opinion, *supra*, 34 F.P.C. at 239.

small producer contracts permitting increases above just and reasonable limits would not have a similar impact was not explained.

The Commission's justification for its action is sparse, and limited to summary statements of objective. Since the Commission as indicated above, purported not to be "deregulating" small producer sales, it confines its legal analysis of its action to a bare denial of the claim that the provisions of Sections 4, 5 and 7 of the Act are "mandatory and leave no room for administrative judgment and discretion", and a reference to the Supreme Court's language in the *Permian Basin Area Rate Cases,* noted above, relating to the Commission's classification powers under Section 16 of the Act (App. 146).

On the merits, the Commission no longer concludes that the impact of its action is *de minimus,* since it finds its action will affect over 10% of the gas purchased by pipelines from producers and an unspecified additional amount of gas purchased by large producers for resale to pipelines (App. 137). But it repeats without elaboration, the statement from its Notice that its action will ease the administrative burdens on the small producers and in the Commission's processing of small producer filings (while ignoring the additional burden imposed on pipelines and large producers, as well as upon the Commission in regulating these entities) (*Ibid.*).

Nothing, whatsoever, is stated in the Commission's Order as to why the removal of all price ceilings from flowing gas already committed to the interstate market by the small producer will result in any public benefit. And there is no effort on the part of the Commission to evaluate whether the cost to the consumer of its actions is likely to be matched by equivalent benefits: the implicit assumption of the Commission is that the necessary additional cost to the consumer from its program, no

matter how great, is in the public interest, if it increases the possibility of some increases in gas dedications to the interstate market, no matter how small.

New York filed, on April 19, 1971, a petition for rehearing of Order No. 428 and requested a stay of the effect of the Commission's order until at least 30 days after Commission action on rehearing (App. 214-220). A number of other applications for rehearing were also filed. However, in Order No. 428-B, issued July 15, 1971, the Commission denied the applications for rehearing, and except for a few minor modifications, Order No. 428 remained intact.

**The Court of Appeals Decision**

Petitions for review of the Commission's Order were filed by New York and several large producer or pipeline groups. On December 12, 1972, the Court of Appeals for the District of Columbia Circuit (Judges Wilkey and Robinson, with Judge Fahy dissenting in part) reversed (Pet. App. 1a-22a). The Court did not dispute the Commission's right to classify small producers separately for rate making purposes, or to provide different or higher rates for such producers upon a record providing a factual predicate therefor. But it concluded that the Commission's rule, in freeing small producers from all direct price restrictions and tying the indirect regulation at the purchaser level to sales at prices above the *highest contract price* by a large producer or the prevailing market price in the area for the unregulated *intrastate* sales, had failed to meet the just and reasonable standards established by Section 4 of the Act for all sales in interstate commerce for resale. Judge Fahy was prepared to accept, on an experimental basis, the Commission's contention that it could and would regulate the rates of small producers at the pipeline level. He made clear, however, that, in his view, this would

only be lawful under the Act if the small producers' rates continued to be subject to refund (and presumably immediate reduction) if they were found to be too high as a result of the review in the pipeline or large producer proceedings (App. 11a). He, therefore, would have approved the Commission's order upon condition that it be modified to require such adjustments in small producer rates in the event of such a subsequent finding (*Ibid.*).

## SUMMARY OF ARGUMENT

While the Federal Power Commission in the orders under review freed small producers—those with annual sales of less than 10,000,000 Mcf—from all price regulation under the Natural Gas Act, it does not claim to have done so pursuant to any statutory power to exempt any class of natural gas companies from the rate provisions of the Act. Instead, it purports to have substituted indirect regulation at the pipeline and large producer level when these purchasers of the small producers' gas seek to pass on the costs to their customers. The Court of Appeals determination that this scheme for indirect regulation was unlawful is clearly correct.

1. Contrary to the Commission's contention, advanced for the first time in its brief on the merits in this Court, the Commission's Orders do not provide for an independent determination at the pipeline level of whether the small producers' sales to the pipeline were just and reasonable. Instead, the Commisison made clear that it would not question any pipeline's purchase of gas from small producers as long as the rate for such gas was at or below the level of the *highest* contract rate of any large producer or the prevailing rate for sales in the unregulated intrastate market. This was a deliberate action since the Commission's basic objective was to permit small producers to change more than the prevailing maximum area or national just and reasonable rate, and

it believed it essential to advise the pipeline and large producer purchasers of the extent to which they could freely pay such out-of-line rates. Only if the rate exceeded these parameters does the Commission contemplate an examination of whether, on the basis of its consideration of all relevant factors, the rates nonetheless meet the standards of the Act.

2. The highest contract rate or prevailing intrastate sales price is not a proper standard for determining whether interstate sales of natural gas for resale meet the Act's just and reasonable standard. On the contrary the courts have repeatedly rejected less extreme examples of market price standards even when they have been sought to be applied in certificate proceedings to fix the initial "in-line price" prior to the establishment of just and reasonable rate levels. See *Atlantic Refining Company* v. *Public Service Commission*, 360 U.S. 378; *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223; *Federal Power Commission* v. *Sunray DX Oil Co.*, 391 U.S. 9. They are *a fortiori* inapplicable in fixing the just and reasonable price itself. While the Commission is not bound to any one regulatory format for fixing just and reasonable rates and in appropriate circumstances may not have to rely entirely on a cost based approach, there is nothing in the record in this proceeding which could conceivably justify equating the just and reasonable price for small producer sales with the highest levels of the unregulated market place. There arguably might be justification for setting the just and reasonable rates for small producers at a higher level than that fixed for producers as a whole—though no attempt has been made by the Commission here to provide the factual predicate for such an effort. But the Commission's market standard is simply deregulation, a matter for legislative concern rather than administrative action under the existing Act.

3. Assuming that the Commission provided for comprehensive regulation of the rate levels of small producer sales in pipeline rate proceedings, no such indirect approach to the Commission's statutory responsibilities is permitted by the Act. On the contrary, in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, when this Court first held that producer sales were subject to the Act's requirements, it expressly concluded that Congress did not intend to restrict regulation of the rates of sales of gas in interstate commerce to those made by the interstate pipelines. The Commission's Order in expressly freeing small producers from any refund or rate reduction obligation if it finds their sales prices to be too high upon its review of pipeline costs, merely reverts to the situation *Phillips* held to be unlawful. Regulation through a determination of whether a pipeline's costs of doing business, including the costs of purchased gas, are reasonable in the sense of being prudent under the circumstances in which the company finds itself, is, as a matter of law, not the same as regulation to determine whether the sales price itself is just and reasonable. The standards therefore are thus necessarily different. Moreover, as a practical matter, it simply is not feasible for the Commission to determine *ab initio* the propriety of a large number of small producer sales in the course of a pipeline rate proceeding, even if that proceeding is limited to purchased gas costs.

4. The Commission's Orders are, if anything, less defensible with respect to the unlimited increases they authorize in the rates small producers may charge for gas flowing under existing sales. For, unlike the case with new sales, the Commission's Order makes clear that there will be no review of the increased costs resulting from freeing such sales from direct rate regulation in any pipeline or large producer rate cases. The matter is by no means *de minimus* since well over 10% of the gas

presently moving in interstate commerce is sold by small producers and many of their sales contracts provide for rates susbtantially in excess of the maximum just and reasonable area rates. Nor has the Commission ever attempted in its orders or brief to justify its action with respect to existing sales as a matter of law, fact or policy.

## ARGUMENT

### Introduction

While the basic objective of the Commission's proceeding continues to be the complete deregulation of small producers from the rate provisions of the Natural Gas Act, its actions to achieve this result are now camouflaged in terms of the indirect regulation of such sales at the purchaser level. The Natural Gas Act does not authorize any such effort to free one level of sales by natural gas companies in interstate commerce for resale from regulation and to impose the entire burden for protection of consumer interests upon the intermediate large producer or pipeline purchasers when they resell the gas. And the practical problems of determining whether the host of individual small producer sales to a large producer or pipeline, at prices in excess of the general area or nationwide just and reasonable maxima established for natural gas producers, meet the standards of the Act are so great as to in themselves invalidate the project.

As the Court below recognized, however, even assuming that some type of indirect regulation of small producer sales was permissible under the Act, the Commission's Orders and its rule adopted therein must be set aside. For in addition to freeing small producers from any refund or rate reduction obligation for all of their sales, they provide that the costs of new small producer sales to the pipelines or larger producers may be passed on to gas consumers whenever they are no higher than

the highest large producer contract price or the prevailing area rate in the unregulated intrastate market. There is no legal or factual predicate for equating the just and reasonable level for small producer sales with such wholly unregulated criteria. And the invalidity of the Commission's actions are, if anything, even more patent, with respect to the existing sales being made by small producers, which the Commission freed from all regulatory restraint without any pretense of indirect review thereof at the large producer or pipeline level.

## I. The Commission's Plan for Indirect Regulation of Small Producer Rates is Based Upon a Market Standard for Judging the Propriety of Such Rates Which is Invalid Under the Natural Gas Act.

### A. *The Commission's Rule and Orders Provide that Small Producer Sales Costs May Be Passed On To Consumers Whenever the Rates are Consistent with the Highest Contract Prices of Large Producers or the Prevailing Market Price of the Unregulated Intrastate Market.*

The Commission at no less than three places in Order No. 428 (App. 140, 142, 150) made clear that pipelines and large producers [6] will be entitled to pass on to their customers whatever price they have paid to small producers for gas under *new* [7] small producer sales as long as these rates:

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[6] In the case of large producers, the costs of gas purchased from small producers can only be assured of being passed on to pipeline purchasers if, in addition, "the price differential between the purchase and resale prices does not exceed the prevailing price differential in the area" (App. 140, 142). But the Commission made clear this price differential would permit the large producers "to maintain the contract price difference between their purchase and resale prices" (App. 140).

[7] In the case of increases authorized by Order No. 428 in the existing sales by small producers to pipelines to their contract maxima (except for indefinite escalations) the Commission made

> ". . . are not unreasonably high, considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area."

It was on the invalidity of this standard under the Natural Gas Act that the Court below primarily grounded its decision reversing the Commission. In its brief in this Court, however, the Commission attempts to argue that the Court below erred in concluding that "the Commission has clearly tied its determination to factors which it does not regulate or which derive solely from market forces" (Pet. App. 12a). The Commission's Order, it suggests (Br. 15-20), provides instead for consideration of "all relevant factors" pertaining to whether a particular small producer rate is "unreasonably high", of which the "two stated factors are only some of those which will be considered." If this were the true situation, the Commission's Order would still be subject to extremely serious questions discussed in Part II of this brief. But the fact of the matter is that the court below correctly construed the Commission's Order. Specifically, while the Commission indicated it was prepared to consider other factors in justification of a pipeline or large producer passing on costs from small producers where the contract price is *in excess* of the "highest contract price prevailing intrastate market price" standard, it repeatedly advised all parties that, where the small producer rate meets this standard, no further investigation will be made and the sale price will not be considered to be "unreasonably high".

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clear on rehearing that "there is no reduction or refund obligation with respect to increased small producer contracts" (App. 146, n. 5). In other words, there is not even to be any indirect regulation with respect to these sales, which in 1971 amounted to over 1,621,000,000 Mcf. See the more detailed discussion at pp. 42-46, *infra*.

The Commission's determination to give advance approval to the pipelines and large producers tracking in their rates small producer sales meeting this highest contract price/prevailing intrastate market price standard was a deliberate one, which it felt to be essential to its basic plan. On the one hand the primary purpose of the rule was to permit small producers to charge and collect rates which were *higher* than the prevailing just and reasonable area (or nationwide) norms without the necessity of filing individual requests for exceptions therefrom;[8] otherwise the pre-existing provisions of Section 157.40 of its Rules for small producer certificates, authorizing sales without further filings up to the area rates (see Order 308, *supra*, 34 F.P.C. 1202) would have been adequate. At the same time the Commission recognized that if it was to attempt to control the extent of those rate increases through its regulation of the purchasers it would at least be necessary to give them—the pipelines and large producers—some firm guidelines as to the degree to which they could deviate from the established just and reasonable norms with impunity. And, as the Commission also made clear (App. 143) it assumed that large producers and pipelines in their own best interests would

[8] At the time of the adoption of Order No. 428, requests for individual waivers of the area rates upon a showing of good cause were the vehicle for such requests. See, *e.g.*, *Permian Basin Area Rate Proceeding*, 34 F.P.C. 159 (1965), affirmed on this point, *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 771-773. Since that date the Commission has established a so-called "optional procedure" under which producers can seek certificates at rates in excess of the area just and reasonable maxima in individual certificate proceedings in which the Commission will, it states, determine whether the requested rate for the particular sale has been shown to meet both the just and reasonable standards of Sections 4 and 5 of the Act and the public convenience and necessity standard of Section 7. See *Optional Procedure for Certificating Sales of Natural Gas in Interstate Commerce*, 48 F.P.C. 218; Section 2.75 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 2.75. The validity *vel non* of this rule is pending on review in *Moss* v. *Federal Power Commission* (C.A.D.C., No. 72-1837).

normally keep within these market price parameters in contracting with small producers and thus to this extent, at least, protect consumers from prices in excess thereof.

The Commission's intent is made clear in Order No. 428-B where it said (App. 246):

> ". . . The Commission in the July 23 notice proposed to allow pipeline purchasers to file tracking increases of rate increases resulting from the issuance of blanket certificates, but that the collection of these tracking increases was to be subject to reduction and refund. In response to Consolidated's claim that the collection should not be so conditioned, the Commission in Order No. 428 modified the original proposal so as to limit the reduction and refund obligation of tracking increases to those *which reflect small producer prices for new sales above the standard set forth therein.* The standard also provides pipelines with a more concrete guide for the future actions than would exist in the absence thereof. *Simply put, the Commission wanted the pipelines to know in advance the boundaries within which they could freely contract with small producers*" (Emphasis added, footnote eliminated).[9]

The Commission's present about face, while understandable in view of the impossibility of justifying its contract price-intrastate market price standard, cannot be justified by the language of the Commission Order on which it relies. Thus, there is no qualification, whatsoever, about the circumstances under which large producers rate increase filings will be acepted without challenge "to per-

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[9] At page 24 of its brief in the Court below, the Commission fully recognized the true import of its Order, stating in response to pipeline contentions that the standard was too vague, that "the sole reason for setting forth the standard was to enable the pipelines to know in advance, with a greater degree of certainty, the boundaries within which they might contract freely with small producers, and thereafter include the costs relating thereto in their cost of service."

mit them to maintain the contract price differential between their purchase and resale prices" resulting from exempting small producers from all price contracts (App. 140). These filings, the Commission stated:

> ". . . shall be accepted, without refund obligation, as long as the price differential is consistent with prevailing price differentials in the area and as long as the small producer prices for new gas are not unreasonably high, considering appropriate comparisons with highest contract prices [for sales][10] by large producers or the prevailing market price for intrastate sales in the same producing area (*Ibid.*).

And this formulation of the standard was adopted, virtually without change [11] as Section 157.40(f) of the Commission's Regulations Under the Natural Gas Act, 18 C.F.R. § 157.40(f).

The discussion in Order No. 428 with respect to the circumstances under which pipelines may pass on the prices they pay small producers (App. 142-143) is somewhat lengthier but no less clear on the critical point that no question will be raised if the price is at or below *either* the highest large producer contract price *or* the prevailing intrastate market price in the area. The discussion is in response to a pipeline contention that their tracking rate increases should not be subject to any refund or reduction in view of the fact that the small producers are being freed therefrom. The Commission rejects this contention with respect to *new* small producer sales, "but only as to that part of the rate which is unreasonably high considering," etc. It then goes on to state that "tracking increases to the extent that they reflect small

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[10] The bracketed words appear in Order No. 428, but were inadvertently left out in the Appendix.

[11] In the rule, the words "without refund obligation" are omitted, and the word "if" substituted in both places for the words "as long as".

producer prices for new sales above the standard set forth above may be suspended" and collected subject to reduction and refund (App. 142). It is in this context of a suspension of tracking filings seeking to pass on above standard rates that the Commission states it will consider "all relevant factors". And if there was any doubt left that this was its intent, the Commission follows it up with the statement that "in this manner *the market mechanism* in the light of regulation of pipeline rates will be protective of consumer interests" (App. 143).[12]

In short, the Court below was quite correct when it concluded that the Commission's indirect regulation of small producer rates was to be based upon a standard which would test the validity of the rates by their consistency with either of two levels—the highest large producer *contract* rates or the prevailing *intrastate market* price—neither of which was a regulated rate nor had any necessary relationship to a rate's conformity to the just and reasonable standard of Sections 4 and 5 of the Natural Gas Act.

### B. *The Standard Adopted by the Commission for the Indirect Regulation of Small Producer Rates Is Inconsistent With the Natural Gas Act.*

Since the Commission now purports to deny that it has adopted an unregulated market price standard for determining, albeit indirectly, whether small producer rates are just and reasonable, its brief does not directly attack the court of appeals' rejection of this standard. Nor does it attempt to meet the promise of its Petition for a Writ of Certiorari (pp. 12-13) of demonstrating the

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[12] This language is followed by a paragraph reiterating that "if the resales by large producers to pipelines reflect new small producer sales at *prices in excess of the previously discussed standard*, the large producers' rates will be subject to suspension and refund" (App. 143).

validity under the Natural Gas Act of a Commission determination that "reliance on the market mechanism would encourage the highly competitive small producers to explore for new supplies of natural gas and would result in just and reasonable rates in the best interests of consumers". The Commission's failure in this respect would constitute a confession of error in the light of the showing above that the market standard is indeed the one prescribed by Order No. 428. It can, therefore, be confidently expected that the Commission will attempt to regroup and support the market standard in its Reply Brief. Its implicit recognition of the indefensible nature of its true position was, however, quite sound.

At the outset it should be recognized that the Commission's standard for determining whether small producer rates will be subject to challenge uses as its test contract price levels which are not only not subject to any regulatory limitation but certain to be substantially above whatever just and reasonable norm the Commission may have established. As the Commission's brief admits, (p. 16 n.10) large producer contract prices will "frequently" tend to be in excess of the area just and reasonable maximum, in the hope that the ceilings will be lifted by subsequent Commission actions, or deregulation legislation may be adopted. There is little if any data as to the extent that the "highest" of such rates will exceed the area limits, but evidence introduced by the Commission staff in a recent case indicated that in one period between November 1971 and January 1973 there were a number of sales made from the Southern Louisiana area at the area rate of 26 cents per Mcf which carried an initial contract price of as much as 45 cents per Mcf.[13] And

[13] See *Belco Petroleum Corp.*, —— F.P.C. ——, Docket No. CI73-293, Opinion No. 659, issued May 30, 1973. (Exhibit Nos. 10 and 27, which contain this data are not referred to in the Commission's Opinion).

recent contract prices for short term sales of gas in interstate commerce have ranged up to as high as 52-54 cents per Mcf,[14] though no area rate, including those established in 1973, is in excess of 35 cents per Mcf.[15] As for intrastate prices, there is no definition of "prevailing rate" which permits one to know whether the Commission is thinking in terms of a weighted average (for which there, to the best of our knowledge, is no existing data base) or the highest rate for substantial volumes of gas. But, recent Commission decisions have referred to individual sales at prices as high as 60 cents per Mcf.[16]

This is not the first time that the Commission has sought to utilize a market standard for evaluating the acceptability of producer rates under the Natural Gas Act. It attempted to do so in the late 1950's as the test for determining under the public convenience and necessity standard of Section 7(e) of the Act, whether producer sales should be certificated *pending* its determination of the just and reasonable rates for such sales. Such efforts were without exception rejected by the Courts, which held that not only must the Commission "hold the line" on producer prices pending determination of the just and reasonable rate levels, but could not certificate producer sales on the basis that they were no higher than others in the area which had not been certificated by the Federal Power Commission, or which, though certificated, were "suspect" in that they were in process of

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[14] See *Cities Service Oil Company*, Docket No. CI74-49, Initial Decision issued January 4, 1974.

[15] This rate was established on August 7, 1973 for new gas from the Permian Basin in the second round area rate proceeding for that production area. *Area Rate Proceeding (Permian Basin Area II)*, — F.P.C. —, Opinion No. 662.

[16] See *Atlantic Richfield Co.*, Docket No. CI73-691, Order of October 10, 1973 (unreported), issuing limited term certificates. Substantially higher intrastate prices have been reported in the trade press and cited in pleadings in pending Commission cases.

being reviewed or otherwise did not support the higher new price level. *Atlantic Refining Company* v. *Public Service Commission (CATCO)*, 360 U.S. 378 (1959); *Public Service Commission* v. *Federal Power Commission*, 361 U.S. 195 (1959), reversing *United Gas Improvement Co.* v. *Federal Power Commission*, 269 F.2d 865 (C.A. 3, 1959). *United Gas Improvement Co.* v. *Federal Power Commission*, 283 F. 2d 817 (C.A. 9, 1960), *certiorari denied, sub. nom. Superior Oil Co.* v. *United Gas Improvement Co.*, 365 U.S. 879; *Public Service Commission* v. *Federal Power Commission*, 287 F. 2d 146 (C.A.D.C., 1960), *certiorari denied, sub. nom. Shell Oil Co.* v. *Public Service Commission*, 365 U.S. 192; see *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U. S. 223, 227-229 (1965); *Federal Power Commission* v. *Sunray DX Oil Co.*, 391 U. S. 9, 18-19, 33-34 (1968). As this Court held in *Sunray DX Oil, supra*, at 19:

> "The Commission and the courts generally excluded from consideration or gave diminished weight to those current prices which were 'suspect' because they were embodied in permanent certificates still subject to judicial review; because they were contained in temporary certificates issued on the *ex parte* representations of producers; or because they had been certificated in proceedings before this Court's *CATCO* decision or in proceedings from which representatives of East Coast consumers and distributors . . . had been erroneously excluded . . . .

And earlier in *Callery, supra*, at 227, this Court had noted that:

> "Consumer protection is afforded by keeping the 'in-line' price at the level where substantial amounts of gas have been certificated to enter the market under other contemporaneous certificates, no longer subject to judicial review or in any way 'suspect.'"

The refusal to rely on suspect or out-of-line certificated rates, to say nothing of the highest contract rates or unregulated intrastate sales, in fixing the initial price to set the refund floor prior to determination of a just and reasonable rate, reflected this Court's view in *Federal Power Commission* v. *Sunray DX Oil Co., supra,* 391 U.S. at 25-26, that:

> ". . . a belief that current contract prices in an area approximate closely the 'true' market price—the just and reasonable rate . . . would contradict the basic assumption that has caused natural gas production to be subjected to regulation and which must have underlain this Court's *CATCO* decision—namely, that the purchasing pipeline, whose cost of purchase is a current operating expense which the pipeline is entitled to pass on to its customers as part of its rates, lacks sufficient incentive to bargain prices down."

All of the above is a *fortiori* applicable to demonstrate the invalidity of establishing the highest contract rate level or the prevailing level of the unregulated intrastate market as the touchstone of what is "just and reasonable". As Judge Tuttle, speaking for the Court in *United Gas Improvement Co.* v. *Federal Power Commission,* 290 F. 2d 133, 135 (C.A. 5, 1961) *certiorari denied sub. nom., Sun Oil Co.* v. *United Gas Improvement Co.,* 368 U.S. 823, stated:

> ". . . a price paid for gas as the result of arm's length bargaining with the producer is not, merely because bargained for in a highly competitive market, 'just and reasonable' within the intendment of the Natural Gas Act. . . . This is so because the only justification for giving the Commission the duty to regulate prices was the determination by Congress that the producers have a supply that is so restricted in relation to demand that they have the economic power to bargain for prices that will be injurious to the public. . . ."

This Court need not consider to what extent just and reasonable producer rates must be cost based, and to what extent the Commission may also consider non-cost factors. The Commission has always given some consideration to market prices (see *Permian Basin Area Rate Cases*, 390 U.S. 747, 795), and the lower courts have upheld challenges to the consideration of non-cost factors in addition to costs, as long as they are "clearly labeled as such and their basis explained" (*Austral Oil Co.* v. *Federal Power Commission*, 428 F. 2d 407, 441 (C.A. 5, 1970), certiorari denied, 400 U.S. 950). But no reviewing court has deviated from the position first enunciated in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810, 818, (C.A.D.C., 1955), certiorari denied, 352 U.S. 829, in rejecting the last Commission effort to reply solely on field prices as the test of what is just and reasonable,[17] that costs must be utilized as the "point of departure", with such non-cost adjustments as may be added justified on the basis of "evidence and findings" showing that "the increase in rates thus caused is no more than is reasonably necessary for the purposes advanced for any increase."

On the contrary, while they are in conflict as to the extent to which the Commission may utilize non-cost considerations in fixing just and reasonable area rates for producer sales, both the Fifth Circuit and the District of Columbia Circuit have recently rejected producer arguments that their rates should have been fixed on market standards. See *Shell Oil Company* v. *Federal Power Commission (Other Southwest Area Rate Case)*, —— F. 2d

[17] The Commission in *City of Detroit* had not gone nearly as far as it seeks to go here. The "fair field price" standard, which the Court rejected, was defined as the "weighted average arm's length payments for identical natural in the fields . . . where it is produced," and was substantially below the current range of field prices. See also *Panhandle Eastern Pipe Line Co.*, 13 F.P.G. 53, 63 (1954).

——, (C.A. 5, Case Nos. 72-1114, *et al.*, decided June 8, 1973) petition for writ of certiorari pending, Case No. 73-438; *Texas Gulf Coast Area Natural Gas Rate Cases*, —— F.2d ——, (C.A.D.C., Case No. 71-1828, decided August 24, 1973) petitions for writ of certiorari pending, Case Nos. 73-966 *et al.*

As Judge Leventhal, speaking for the Court stated in the *Texas Gulf Coast Area Natural Gas Rate Cases*, *supra*, Sl. Op. at 25-26:

> "Another option does remain—that of setting the price of natural gas at the market price, or of allowing the market price to govern the 'just and reasonable price' of natural gas. A variant of this contention is the submission by the producers that in time of supply shortage, regulation for an area that serves not only an interstate market but also an (unregulated) intrastate market must set the regulated prices as high as the unregulated in order to prevent diversion to the intrastate market. However, so long as the legislature has assigned the agency the function of regulation of rates, it cannot legitimately execute that function in a fashion which, in fact, is tantamount to total deregualtion or nonregulation. Congress did not provide for agency action and court review as a charade" (Footnote eliminated).

Is it true that this Court, in its decision in the *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 795, in rejecting objections to the Commission's findings there that market mechanism was an inadequate surrogate for the just and reasonable standard mandated by the Act, stated it was not holding field prices to be "irrelevant" to the Commission's determination and that "the records in subsequent area proceedings may more clearly establish that the market mechanism will adequately protect consumer interests". But assuming, as the Court did not hold, that in such a case a just and reasonable standard based

solely on the *highest* contract rate or the unregulated intrastate market would be justified, that clearly is not the present situation. There was no study of the adequacy of the market to protect consumers in the Commission's proceeding leading to Order No. 428, and no findings to this effect, based on any factual predicate express or implied is contained in the Commission orders.

On the contrary, in all of its area rate decisions both before and after its issuance of Order No. 428, the Commission has rejected producer claims that it should abandon its cost anchor since the operation of market forces would adequately protect consumers. See, *e.g.*, *Area Rate Proceeding (Permian Basin II)*, Docket No. AR70-1, Opinion No. 662, issued August 7, 1973, Sl. op. p. 4. It could hardly have reached any other conclusion under current conditions. For if the pipelines could not be depended upon to bargain to the extent necessary to provide a private substitute for Commission regulation in periods of relative abundance of gas (see, *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 793-794), clearly they cannot be expected to do so in a period of scarcity.[18]

We do not suggest that the just and reasonable area or nationwide rates for the gas of small producers is necessarily the same as that for producers as a whole. In an appropriate new proceeding data might be developed showing that average small producer costs were greater

[18] Without necessarily suggesting that available gas reserves are being withheld from the interstate market in the hope or expectation of legislative deregulation, it is to be noted that Commission data indicates that as of mid-1972 the four largest independent producers of natural gas between them controlled no less than 48.4% of the reported uncommitted reserves in the United States, exclding Alaska. See, *Statement of John N. Nassikas, Chairman, Federal Power Commission Before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee*, June 20, 1973, Table 7.

than those for the producers in general.[19] Or there might be some factual predicate for providing small producers with a discrete non-cost allowance in excess of the general producer just and reasonable maxima. But an inchote belief that small producers need higher prices to render optimum service to interstate consumers tied, without any demonstration of a proper correlation, to a standard based upon the highest level of contract prices or the prevailing rate in the unregulated intrastate market, is an abandonment of the Commission's responsibilities under the Natural Gas Act to "afford consumers a complete, permanent and effective bond of protection from excessive rates and charges" by insuring that they are no more than necesary to the "maintenance of adequate service in the public interest". See *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 388 (1959).

## II. The Natural Gas Act Does Not Authorize The Indirect Regulation of Small Producer Rates Through the Regulation of the Rates of the Pipelines and Large Producers to Whom they Sell.

Sections 4 and 5 of the Natural Gas Act (F.P.C. Br. 35-38) in unequivocal terms provides for the regulation of all of the jurisdictional rates of all natural gas companies to the end that the rates for each such sale must be just and reasonable. As Section 4(a) makes clear "any such rate or charge that is not just and reasonable is hereby declared to be unlawful." There is no exception to these requirements; unlike such regulatory statutes as the Federal Aviation Act (see 49 U.S.C. § 1386), and the Natural Labor Relations Act (see *Guss* v. *Utah Labor Relations Board*, 353 U.S. 1, 13-14 (1957)), the Federal Power Commission is afforded no general exemp-

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[19] But see footnote 2, p. 6, *supra*.

tion authority.[30] Thus, as the Court below noted (Pet. App. 8a and n. 11), ever since this Court's decision in *Phillips Petroleum* v. *Wisconsin*, 347 U.S. 672, it has been recognized that the Commission had mandatory jurisdiction over the rates of all producer sales in interstate commerce for resale regardless of the size of the producer.

The court below, as we understand its opinion, believed that there were very serious legal questions as to whether the Commission could substitute indirect regulation of jurisdictional sales by natural gas companies for the direct regulation mandated by the Act as interpreted in the *Phillips* case, *supra*. (See Pet. App. 7a-11a). However, it believed it to be unnecessary to resolve this general question in view of the patently improper standard adopted by the Commission for such indirect regulation at the pipeline and large producer level. We agree that this Court is not required to explore the outer limits of Commission authority if it agrees with our arguments in Part I of this brief. But the Commission should be made aware that it cannot cure the errors of its Order merely by adopting the more general standard for indirect review of small producer rates which its brief in this Court purports to support. We have set forth below some of the reasons this is true, leaving

[30] The only provision in the Natural Gas Act authorizing the Commission to exempt natural gas companies from any of its mandatory requirements is found in Section 7(c) of the Act. This provision is limited to permitting the Commission to exempt "from the requirements of this section," such "temporary" acts or operations of natural gas companies "for which the issuance of a certificate will not be required in the public interest."

The issue of whether this provision authorizes the Commission to exempt *temporary* sales by producers from the rate provisions of the Act is pending before the Court of Appeals for the District of Columbia in *Consumers Federation of America, et al.* v. *Federal Power Commission*, Case Nos. 73-2009, *et al.* There, as here, it is contended by the Commission that consumers will be protected from overly high rates through the indirect regulation of the purchasing pipelines.

to the briefs to be filed by the representatives of the pipelines and large producers discussion of the problems more directly affecting their interests.

1. In its original notice of proposed rule making in this proceeding (App. 1-12), the Commission looked towards the frank exemption of small producers from all of the rate restrictions of the Act (App. 2). As its sole authority for such action, the Commission cited (*Ibid.*) the dictum by Justice Clark in *Federal Power Commission* v. *Hunt*, 376 U.S. 515, in which he reiterated a suggestion he had previously made in his dissent in *Wisconsin* v. *Federal Power Commission*, 373 U.S. 294, 329-330, that the Commission might consider exempting producers from at least the certification provisions of the Natural Gas Act.[21] In Order No. 428, the Commission stated its disagreement with arguments that the provisions of Sections 4, 5, and 7 which speak in terms of requirements applicable to all sales in interstate commerce for resale "are mandatory or leave no room for administrative discretion." In addition to the Clark dictum in *Hunt, supra*, the Commission referred to this Court's holding in the *Permian Basin Area Rate Cases*, 390 U.S. 747, that Section 16 of the Act, authorizing the Commission to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters", justified the special treatment of small pro-

[21] Justice Clark's dissenting statement in *Wisconsin* v. *Federal Power Commission, supra*, was in context of his disagreement with the Court approved move towards determining producer rates on an area basis rather than producer-by-producer, and was in terms of a possible "temporary" exemption of small producers while the Commission fixed the rates of the larger producers. *Hunt* involved the propriety of conditions in temporary certificates issued to producers, precluding rate increase filings pending action to fix the initial rate in the permanent certificate proceeding. Justice Clark opined that the administrative delays resulting from dealing with producer certificate applications on an individual basis could be largely avoided if the Commission found itself in a position to exempt small producers from the necessity of filing such applications.

ducers provided in that area rate proceeding. But the Commission no longer asserts this separate treatment of small producers can extend to their exemption from the requirements of the Act. Instead it denies its action constitutes "deregulation", in view of its intent to regulate such sales indirectly by reviewing the purchased gas costs of each pipeline with respect to small producer sales, and the "other safeguards against unreasonably high small producer prices" allegedly provided in its Order (App. 138).

If it were legally and technically feasible to ensure through such indirect regulation that producer rates met the Act's just and reasonable standard it conceivably could be held that the Commission met its statutory responsibilities by the indirect path it has chosen, despite the seeming language to the contrary in Sections 4 and 5 of the Act. See *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 374, where the Court rejected a somewhat similar argument against group rate making based upon an overly literal reading of the language of Sections 4 and 5. But this is not what the Commission intended by its scheme for indirect regulation. As we demonstrated in Part I of this brief, the standard which the Commission has adopted for determining whether the pipelines and large producer purchasers of small producer gas are entitled to pass on the costs of such sales to their customers, constitutes a complete abandonment of any effort to keep small producer rates to a "just and reasonable level". It is noteworthy in this respect that the single reference in either Order No. 428 or 428-B to the just and reasonable rate standard prescribed by the Act for all jurisdictional sales, is where the Commission states that indefinite escalation clauses in small producer contracts will only be permitted to operate to the extent they permit increases to the "applicable area just and rasonable rate

ceiling" (App. 138). But even if the Commission had fixed upon the just and reasonable area rates—or some other valid test of a just and reasonable rate—as the touchstone against which the actions of the pipelines or large producers would be judged, its actions would still be invalid.

Contrary to its suggestion that it had adopted "an innovative method of indirect regulation" which is responsive to the "unique problems and public functions" of small producers (F.P.C. Br. 11, 13), all the Commission has done is to revert to the situation which prevailed with respect to all producers prior to this Court's *Phillips* decision, *supra*, where the only protection to the public from excess gas costs was through the regulation of the pipelines. It was argued at the time that this was all the Congress had intended, since the danger of producers being able to charge unreasonable prices to the pipelines had not been considered to be serious as of the date the Natural Gas Act was adopted, but such contentions were rejected by the Court. See, *e.g.*, 347 U.S. at 681-682. Now that these incipient fears have proven to be very real, the Commission has retreated for this large class of producers to the regulatory scheme proscribed almost twenty years previously.

Far from "regulating" the small producers rates at the pipeline or large producer level, the Commission has expressly provided that even if such sales are subsequently held to be above the prescribed standard, the particular sales will not be subject to refund, or even prospective reduction. As the Commission stated in Order No. 428, "we seek to assure the small producer that when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change." (App. 137) Any doubt on this question was removed in Order No. 428-B where the Commission rejected a pipeline proposal under which it would review

the small producer rates within a 60-day period, but the producer, if he did not wish to accept the Commission prescribed rate level, could terminate deliveries without refund obligation, stating (App. 249):

> "The proposal does not go far enough. We want to facilitate the entry of the small producer into the interstate market and to assure the small producer that *when he enters into a new contract, the provisions of this contract will not be subject to change.* This can best be accomplished within the framework of the procedure we have adopted in Order No. 428." (Emphasis added)

Consistent with this statement, Section 157.40(c) of the rule adopted by the Commission in Order No. 428, 18 C.F.R. § 157.40(c), provides simply that "small producers certificated hereunder shall be authorized to make small producer sales nationwide pursuant to existing and future contracts at the price specified in each such contract."

The Commission brief does not dispute the fact that no refunds will be ordered no matter what the result of the "indirect" review of the propriety of the small producer's rate level. It does not suggest that a reduction in an unreasonable small producer rate will result from the pipeline review thereof. (It could not do so since the small producer's rates will not be in issue in the pipeline rate case and the small producer will apparently not even be a necessary party to the proceeding.) But the Commission brief does suggest (at p. 15) that in such circumstances it "remains free to institute separate proceedings under Section 5(a) to reduce the rate prospectively." This may be the situation as a matter of law, since there is nothing in the Act to foreclose the Commission from exercising authority it has previously foresworn. But see *Service* v. *Dulles*, 354 U.S. 363. But any

such action is not part of the Commission's regulatory plan.

The Commission's statement (App. 145) that it intends to continue to review small producer contract prices to assure their reasonableness under the regulatory plan it had adopted and "in the event we determine that *this approach* is inimical to the interests of consumers, we shall take further action to protect the consumers" (emphasis added), does not suggest that the Commission contemplates action to reduce existing sales. It is, on the contrary, merely a promise to review the results of its new program to determine whether it should be modified in the future. And in any event, this Court's *CATCO* decision (*Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 389-391), long ago determined that the availability of future Section 5 proceedings cannot justify existing rates which fail to meet the standards of the Act.

Even Judge Fahy who thought that the Commission's Order could in other respects be accepted as a good faith effort to develop an experimental regulatory program for small producers within the mandate of the Act, recognized that the Order to be lawful would have to provide for refunds (and presumably immediate rate reductions) by small producers to the pipelines or other jurisdictional purchasers in situations where they have been found to have charged unreasonably high prices (Pet. App. 22a)—a standard which he, erroneously in our view, equated with a Commission effort to determine indirectly the just and reasonable rates for such sales (Pet. App. 21a). But as the Court majority below pointed out (Pet. App. 10a-11a, n. 17) this requirement, in addition to compounding the uncertainty for all parties, would defeat the basic purpose of the Order, which was to assure small producers of their contract rates—whatever their level.

The indirect regulation proposal is, however, subject to other serious and we believe inherently fatal legal and practical problems. For the standards for judging whether the costs at which a regulated utility purchases equipment or supplies are quite different from those under which a regulatory agency will determine whether a regulated seller's price is just and reasonable. See *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 622-623 (dissenting opinion).

The Commission's brief (pp. 32-33) cites its statement in Order No. 428-B (App. 245) that ever since the adoption of the Act "pipelines as regulated utilities have been permitted to include in their cost of service only those operating expenses, including the cost of purchased gas, which are reasonable", and argues further that such a standard of reasonableness is not unconstitutionally vague. But this statement is only true in the context of the basic regulatory principle that a pipeline or other regulated entity can include as part of its cost of service (if it is fixed on a cost basis at all), all prudent operating expenses contracted for under arm's length conditions irrespective of whether the sales price would be "just and reasonable" for a regulated seller. "If properly incurred, [expenses] must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce" *Mississippi River Fuel Corporation* v. *Federal Power Commission*, 163 F.2d 433 (C.A.D.C., 1947). Or as the Commission itself stated in *Texas Eastern Transmission Corp.*, 29 F.P.C. 249, 256 (1963), affirmed *sub. nom. United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1969), in rejecting as inadequate the indirect control of producer costs through regulation of a pipeline:

> ". . . Control limited to approving the costs of the gas to the purchasing pipeline is, of course, not an

effective way to regulate producer prices because in the large a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities."

Consequently, in the absence of a showing of collusion or gross neglect, expenses of gas pipelines, including purchased gas costs, will necessarily be accepted as "reasonable" [22] if they are not totally out of line with general market rates for the service or commodity, regardless of whether this cost could be characterized as just and reasonable on any regulated basis.

Even if these problems of inconsistent regulatory theory could be surmounted, the practical problems inherent in indirect regulation of a large number of individual small producer sales at the pipeline or large producer level are so immense as to render any agency claim that it could or would actually review their propriety on a case-by-case basis subject to the highest degree of skepticism. The Commission stresses in both its Notice (App. 2) and Order No. 428 (App. 137) that one of its major objectives is to relieve both small producers and *itself* of the administrative burdens of regulation. As we have indicated, *supra*, p. 7, under the program initiated by the Commission in the *Permian Basin* proceeding, 34 F.P.C. 159, 234-236, and effectuated by its Order No. 308, *supra*, 34 F.P.C. 1202, the administrative burdens on small

[22] In an earlier case in which the issue was the determination of the atcual legitimate original costs of a regulated utility's hydro-electric project, the Commission had stated, in language which we believe is equally applicable to the issue of disallowing pipeline operating costs, that "a claimed cost may be so in excess of the cost of comparable construction or purchase that it raises a question of *collusion, fraud* or *gross neglect* which would cast on the licensee the burden of proving the circumstances which would justify the claimed cost, and in the absence of such proof the claim in excess of what is reasonable should be disallowed. *Pennsylvania Power & Light Company*, 3 F.P.C. 89, 119 (1942) (emphasis added).

producers willing to sell at prices up to the area just and reasonable rates had been all but eliminated.[23] But if the Commission actually attempts to determine whether each of the small producer sales which will have been made to particular pipelines were just and reasonable in the pipeline's rate case, we would be returned with a vengeance to the administrative morass which led to the adoption of area rates for producers in the first instance. See *Wisconsin* v. *Federal Power Commission*, 373 U.S. 294 (1962). This is particularly true if, as the Commission now suggests, it would consider all relevant factors in reaching its determination and not operate according to any fixed standard.

Pipeline rate cases are complex and time consuming even in the absence of issues as to whether a large number of individual gas purchases from small producers at prices in excess of the established area or nationwide just and reasonable norms are nonetheless just and reasonable because of special circumstances of such sales. Presumably the Commission now contemplates that such issues would not normally arise in proceedings on general pipeline rate increases but would be considered sep-

[23] Under Order 308, as modified from time to time, small producers could secure blanket certificates authorizing them to secure the area just and reasonable area rates to the extent their contracts permitted without any further actions on their part. Any remaining administrative burdens related (1) to their need to secure certificates in those areas in which no area just and reasonable rate had been fixed—a situation of minimal significance today, (2) the need to making filings if they wished to secure rates in excess of the general area rate, in view of the Commission option given them to seek special relief with respect to particular sales if they so desired, and (3) some temporary problems which existed when Commission area rate orders were stayed on review, to permit small producers to continue making sales at rates in excess of the area rate, *pendente lite*. The Commission has never discussed the burden issue in any detail, but presumably the main burden of which small producers are being relieved is of demonstrating that prices in excess of the general area just and reasonable rate are just and reasonable for them.

arately in proceedings on pipeline filings under the purchased gas adjustment clauses recently authorized by Section 154.38(d)(4) of the Commission's Regulations under the Natural Gas Act, 18 C.F.R. § 154.38(d)(4), and specifically made applicable to small producer rate filings under Order 428.[24] To the extent such segregation of issues relating to small producer sales is feasible it will ease the burden, but only marginally. Moreover, since the small producers' rates will not be directly in issue in the pipeline proceeding and the pipeline rather than the small producers will have the burden of justifying such rates, the small producers in many if not most cases will not even be a party to the proceeding. It seems clear that the Commission would not have provided for such indirect review unless it had been convinced that in most cases there would be no difficulty in the pipeline or large producer showing that the rate was no higher than the highest contract rate for a large producer or the prevailing intrastate market rate,[25] and intended to make or require no further inquiry. (See Part I, *supra*).

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[24] While the language of the Commission's Rule on purchased gas adjustment clauses does not appear to contemplate challenge to the reasonableness of the increased cost as long as the calculation is accurate, the Commission in its recent Orders in Docket No. RM74-3, in which it purported to exempt from all direct Commission regulation producer sales of less than a 180 day duration to pipelines experiencing system gas shortages, stated it would review the rates involved in such exempt sales in pipeline rate proceedings, including those involving purchased gas adjustment clause increases, and permit the pipeline to pass them on to their customers only where such rates can be shown to be required by the "public interest". See *Policy with Respect to Establishment of Measures to be Taken for the Protection of Reliable and Adequate Service for 1973-1974 Winter Heating Season,* F.P.C. Docket No. RM74-3, Order No. 491-B, issued November 2, 1973, p. 13.

[25] But Orders No. 428 and 428-B gave no indication as to how the prevailing intrastate market rate is to be determined, or the source of data therefor. (The Commission staff in recent years has periodically published data giving the range of intrastate sales prices, which have varied widely in all periods.) Nor is there any

## III. There Is No Basis For Freeing Flowing Gas Sales By Small Producers From All Price Regulation.

While the basic thrust of the Commission's rule is the need to stimulate additional new gas search efforts by small producers in an era of gas supply deficiency, its Order also frees from any direct price regulation all of existing producer sales of flowing gas (App. 137). Moreover, unlike the situation with new sales, the Commission did not provide for *any* indirect regulation of the flowing gas sales of the small producers. Instead the Commission makes clear that the large producers and pipelines could pass the additional costs of its deregulation of small producer flowing gas sales regardless of the level of the resulting rate (App. 140, 142-143, 246). The Commission's brief contains no factual legal or policy justification for its action with respect to flowing gas, a deficiency which repeats the silence on this matter in Commission Orders 428 and 428-B.[26]

This complete deregulation of all existing small producer sales cannot be defended as *de minimus*. While the Commission attempted to so suggest in its original Notice (App. 2), it admits in Order No. 428 that over ten percent of the sales to the pipelines by independent producers in 1969 were from small producers, with some pipelines purchasing much higher percentages of their total gas supply directly from small producers (App. 137). Moreover, the Commission agrees that this figure understates the problem since it does not include the substantial additional amount of gas sold by small producers to large producers and resold by them to the pipelines (*Id.* at n.

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indication whether the highest large producer contract rate is to be for a sale in the same production area, or to be for gas of similar quality, quantity or vintage.

[26] New York had expressly challenged the justification for any application of the rule to existing sales of small producers in its petition for rehearing (App. 217).

1). The extent of the ten percent of direct pipeline purchases from small producers is known; in 1971 it amounted to approximately 1,621,028,242 Mcf of gas.[27] The amount of sales by small producers to large producers which would be exempted by Order No. 428 is not given by the Commission and, to the best of our knowledge, the Commission has neither published nor maintains any data thereon.[28]

The extent of the immediate exposure of gas consumers from increases in the small producers' rates for flowing gas depends upon the extent to which their contract prices exceed the area rate norms for gas of that vintage. See *United Gas Pipe Line Company* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956). Here again, there is nothing in the record, or in any official compilation of Commission statistics, which permits any exact quantification. But as the Commission brief admits (at p. 16, n. 10), "large producers frequently contract to sell their gas at rates that exceed the applicable area rates", and the Commission's opinions and orders in other proceedings indicate that this excess of contract rate over the just and reasonable area rate ranges in many cases from 5 to 10 cents per Mcf or more. There is some statistical data which indicates that the very small producers (those with sales of under 2,000,000 Mcf per annum) do not average

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[27] See, *Sales by Producers of Natural Gas to Interstate Pipeline Companies* 1971, F.P.C. Office of Accounting and Finance, 1972. Table D, p. XV shows that the total 1971 sales to interstate pipelines by producers with sales of less than 2,000,000 Mcf was 823,844 Mcf. The sales of the producers with sales between 2,000,000 Mcf and 10,000,000 Mcf were calculated by adding the figures therefor shown on Table 1 at pp. 3-6.

[28] The magnitude of this factor of the problem can, however, be indicated by the statement in the record (App. 113-114) that from 40-50 percent of the total jurisdictional sales of Phillips Petroleum Company represented purchases from other producers, most of whom would qualify as small producers. Phillips 1971 jurisdictional sales amounted to 724,194,133 Mcf. See, *Sales by Producers of Natural Gas to Interstate Pipeline Companies, supra*, Table 1, p. 1.

quite as much per Mcf for the gas they sell to the pipelines as the large producers;[29] from these data it can be presumed that the excess of contract rates over area rates on the part of the small producers will be somewhat less than for the largest producers. But even if we assume that the average spread between the contract and area rates of small producrs is only one per cent per Mcf at the present time, the annual cost to gas consumers will be approximately $16,210,282 from direct small producer sales to pipelines alone—to which must be added the indefinite additional amount from indirect sales through large producers. And, of course, when the initial sales contracts expire, the small producers will be able to file unilateral rate increases *at least* up to the levels of the highest large producer contract rates on the prevailing intrastate market price.

The usual Commission excuse for providing revenues to producers for flowing gas in excess of costs, including a fair rate of return, is that this will provide producers with needed capital to reinvest in the search for new sources of gas for the interstate market. This can be expected to be the *ex post facto* rationale for the Commission's deregulation here provided in its reply brief. The validity of the basic concept has recently been rejected by the Court of Appeals for the District of Columbia. See *Texas Gulf Coast Area Natural Gas Rate Cases, Case* Nos. 71-1828 et al., —— F. 2d ——, decided August 24, 1973, petitions for certiorari pending, Case Nos. 73-966 *et al.* But in any event, there were good reasons why the Commission did not so claim in its Orders under review. In the first place, the recent Commission area rate decisions already include allowances in the flowing gas rates of up to 3.5 cents per Mcf for such

[29] See *Sales by Producers of Natural Gas to Interstate Pipeline Companies*, 1971, *supra*, Table B, p. VIII.

purposes.[30] And the Commission has also provided that in addition to the area rates, producers including small producers, can secure advance payments, the amount of which it has never fixed or challenged, from the pipelines for exploration and development purposes.[31] There is no basis for concluding that these allowances, in addition to their regular revenues from flowing gas sales, plus such sums as they can otherwise raise, are inadequate to the small producers' needs, provided, of course, the new gas price incentives are adequate. On the other hand, it is clear that gas consumers will secure no benefit from the Commission's absolute deregulation of such producers' flowing gas sales in the large number of cases that the small producer is no longer actively engaged in gas production, or operates primarily onshore and will in any event sell any new gas to the intrastate market,[32] or for other reasons chooses to take the money and run.

In short, it is clear that with respect to the flowing gas sales of small producers, the Commission has abandoned all regulation, without citing any authority there-

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[30] See *Area Rate Proceeding (Permian Basin II), supra,* Sl. Op., p. 5.

[31] See *Accounting and Rate Treatment of Advance Payments Included in Account No. 166, Advance Payments For Gas Development and Production,* F.P.C. Order No. 465, —— F.P.C. ——, issued December 29, 1972; *Uniform System of Accounts Prescribed for Natural Gas Companies,* 18 C.F.R. Part 201, Account No. 166.

[32] Because of transportation advantages and the absence of alternate fuels, the intrastate market for gas had traditionally been willing and able to pay whatever is necessary above the regulated interstate rate to secure the gas it needs from onshore areas. Gas produced in the Federal domain in the Gulf of Mexico is subject to the plenary authority of the Federal Power Commission since it necessarily involves interstate sales and transportation. See, *United Gas Pipe Line Company,* 30 F.P.C. 560, 562, 564, 597-605, affirmed *Louisiana Public Service Commission* v. *Federal Power Commission,* 359 F.2d 525 (C.A. 5, 1966), certiorari denied, 385 U.S. 833. But the operations of small producers in those areas are quite restricted.

for, and has done so without attempting to provide any factual or policy justification for its action. Even if the Commission's actions with respect to new small producer sales were determined to be within its powers, its actions with respect to the existing flowing gas sales by small producers must therefore be set aside.

## CONCLUSION

For the reasons set forth above, the opinion below reversing and remanding the orders of the Federal Power Commission involved in this proceeding should be affirmed.

Respectfully submitted,

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January 11, 1974

## INDEX

## CITATIONS

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

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No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner,*

v.

TEXACO INC., ET AL., *Respondents.*

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72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., *Petitioners,*

v.

TEXACO INC., ET AL., *Respondents.*

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**On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## BRIEF FOR RESPONDENT INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA [1]

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### PRELIMINARY STATEMENT

The Interstate Natural Gas Association of America (INGAA) is a non-profit trade association representing virtually all of the major long-distance natural

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[1] In proceedings at the Commission and in the court below, and in previous pleadings to this Court, the Interstate Natural Gas Association of America was identified by its former name, that is, the Independent Natural Gas Association of America. The change in name became effective as of January 1, 1974.

gas transmission lines (pipelines) in the United States. INGAA, a petitioner in the court below, urges that the judgment of the United States Court of Appeals for the District of Columbia Circuit be affirmed.

## OPINIONS BELOW

The opinion of the Court of Appeals is reported at 474 F.2d 416. Order No. 428 of the Federal Power Commission (FPC or Commission) (App. 135-154), its amending Order No. 428-A (App. 159-161), and its Order No. 428-B denying rehearing (App. 238-253) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

## JURISDICTION

The judgment of the Court of Appeals was entered on December 12, 1972, and the Commission's petition for rehearing was denied on February 5, 1973. The petition for a writ of certiorari was filed on May 3, 1973, and was granted on October 9, 1973 (App. 254).[2] The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

## QUESTION PRESENTED

Does the Federal Power Commission have authority to exempt small producers[3] from direct rate regulation

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[2] The Court concurrently granted the petition in *Dougherty, et al.*, No. 72-1491—which sought review of the same judgment of the Court of Appeals—and ordered the cases consolidated for oral argument (App. 254). Reference is made in this brief principally to the petition of the Federal Power Commission, No. 72-1490, inasmuch as *Dougherty, et al.*, do not raise any significant points not already raised by FPC.

[3] "Small producers" are those producers selling annually 10,000,000 Mcf or less of natural gas for resale in interstate commerce.

under the Natural Gas Act (Act) by shifting the burden of establishing the reasonableness of rates for interstate wholesale sales of natural gas from the sellers (small producers) to the purchasers (interstate pipelines or large producers)[4] despite statutory language to the contrary?

## STATUTES INVOLVED

Sections 4, 5, 7 and 16 of the Natural Gas Act, 15 U.S.C. 717c, 717d, 717f, and 717o, are set forth in the Appendix to the Commission's brief, pp. 35-43.

## STATEMENT OF THE CASE

### A. Background

Ever since the landmark decision of this Court in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954), holding that the FPC had jurisdiction under the Natural Gas Act to regulate well-head sales by producers of natural gas to interstate pipelines, efforts have been made to determine appropriate procedures for regulating such sales by the numerous small producers of natural gas. The administrative difficulties in regulating thousands of producers on an individual company basis was one of the principal reasons that prompted the Commission to adopt area rate procedures as the solution for its producer rate problems in the second *Phillips* case, 24 FPC 537 (1960).

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[4] Large producers often purchase gas from small producers and subsequently resell the gas to interstate pipeline purchasers. We recognize that large producers may thus be aggrieved in somewhat the same manner as are the interstate pipelines by Order Nos. 428 and 428-B, but in this brief, INGAA will restrict its discussion to the impact of the Commission's unlawful action upon its pipeline company members.

The Commission's determination to depart from its practice of individual producer rate cases was affirmed by this Court in *Wisconsin* v. *Federal Power Commission,* 373 U.S. 294 (1963). In the first of its series of area rate proceedings, *Permian Basin Area Rate Proceeding,* 34 FPC 159 (1965), the Commission also determined that special administrative treatment for small producers would be appropriate to ease the burden of regulation, 34 FPC at 234-235. At the same time, however, it concluded that outright exemption of small producers, assuming that such was legally permissible, was not "necessary or desirable" (*ibid*). While it, therefore, made the area "just and reasonable" rates applicable to all producers, small and large, the Commission initiated action to relieve small producers of virtually all of the administrative burdens and costs of both the rate and certificate provisions of the Natural Gas Act. This action was embodied in Order No. 308, 34 FPC 1202 (1965) and took the form of the establishment of "Small Producer Certificates" available to any producer with jurisdictional sales of less than 10,000,000 Mcf of gas per year. Under such a certificate, the small producer could undertake all of his existing sales, and any new ones, so long as he did not exceed the annual volume limitation and the applicable "just and reasonable" price ceilings for the particular area.

In its decision affirming the Commission's *Permian Basin* opinions, this Court also expressly affirmed the special administrative treatment afforded to small producers, finding that a proper factual basis existed for such treatment, and that such action was "fully consistent with the terms of [the Commission's] statutory responsibilities." *Permian Basin Area Rate Cases,* 390

U.S. 747, 787 (1968). The Court's opinion, however, does not hold that the Commission's power to so classify small producers for special regulatory treatment pursuant to Section 16 of the Act, also authorized it to exempt them from all direct rate regulation by shifting the burden of establishing the justness and reasonableness of rates for interstate wholesale sales of natural gas from the sellers (small producers) to the purchasers (interstate pipelines or large producers).

### B. The Present Proceedings Before The Commission

On July 23, 1970, the Federal Power Commission issued, in Docket No. R-393, a Notice of Proposed Rulemaking entitled "Exemption of Small Producers from Regulation" (App. 1-13). In essence, the Commission proposed to exempt small producers from rate regulation under the Natural Gas Act, permitting them to collect and keep any contractually negotiated prices for gas sold in interstate commerce for resale. The Commission undertook in the Notice to assure small producers that their contract price would not be subject either to refund or prospective change by the FPC. The stated purpose for this proposed action was to stimulate additional exploratory efforts and dedication of gas reserves to the interstate market in order to augment the dwindling supplies. The Commission's principal asserted authority for its proposed rule was its classification powers under Section 16 of the Act.

The Commission did not propose to free small producers from all regulation under the Act, however, announcing that, among other things, it would retain abandonment authority over small producers' sales pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b), as well as requiring certain annual reports. Further,

the Commission proposed to allow pipelines to file "tracking" rate increases [5] to recover increases in their purchased gas costs which were anticipated as a result of exempting small producers from rate regulation.

After receiving comments from various parties, the Commission issued Order No. 428, entitled "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Repirements" (App. 135-154). The Order, in general, followed the proposal indicated by the Commission's Notice of July 23, 1970, with respect to exempting small producers from rate regulation. However, for the first time, the Commission indicated that the pipelines' right to "track" increases in purchased gas costs would be limited to that portion of the contract prices paid to small producers which the Commission, in later proceedings, finds justifiable, i.e., not "unreasonably high." The essence of the newly announced "indirect" scheme is set forth in the following excerpts:

> "The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales *but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers' sales.*" (Emphasis supplied.) (App. 138).
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> "Any question as to the propriety of the price paid by a pipeline to a small producer *will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified.* The

[5] "Tracking" rate increases authorized by the FPC are similar, in concept and effect, to the more familiar "fuel adjustment" clauses.

Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent." (Emphasis supplied.) (App. 139).

* * *

"*Small producers will have no refund obligations* with respect to increased rates * * * However, the *pipeline's rates will be subject to reduction and refund,* with respect to new small producer sales, but only *as to that part of the rate which is unreasonably high* considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." (Emphasis supplied.) (App. 142).

INGAA and its pipeline members were, theretofore, unaware that the Commission's proposal for deregulation of small producers raised a substantial issue with respect to the pipelines' ability to recover their legitimate expense items of purchased gas, contracted for in good faith efforts to render adequate service to their customers. INGAA, as did certain of its pipeline members, petitioned for rehearing of Order No. 428 and urged the Commission to correct this situation. On July 15, 1971, the Commission issued Order No. 428-B (App. 238-253), which modified Order No. 428 in certain respects not at issue herein but reasserted the Commission's authority to engage in the unprecedented scheme of so-called "indirect" small producer rate regulation at the pipeline level.

### C. The Decision Below

The Court of Appeals, with one judge dissenting, set aside the Commission's action exempting small producers from rate regulation after concluding that such

action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).[6]

The lower court's decision turned upon an analysis of specific provisions of the Natural Gas Act, namely, Sections 4, 5, 7 and 16 (FPC Pet., pp. 85a-93a). The court concluded, in effect, that the regulation of rates for jurisdictional sales was *mandatory,* and not discretionary or permissive, regardless of the size of the regulated entity. In that connection, the court held that the Commission's Section 16 classification powers do not permit the exemption of small producers from rate regulation under Section 4 of the Act (FPC Pet., pp. 7a-10a). That being the case, the court held that the Commission's Order Nos. 428 and 428-B represented a clear-cut abdication of statutory duty to assure that *all* regulated rates, including those of small producers, be "just and reasonable" (FPC Pet., pp. 10a-16a). This departure from statutory duty and standards through the so-called "indirect" mode of regulation at the pipeline level contravened the provisions of the Natural Gas Act:

> "Nothing at all insures that those levels [of rates allowed to be passed on to consumers] will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a-13a).

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[6] Reference is to FPC's Petition for Certiorari, No. 72-1490.

Even the dissenting Judge (Fahy) would not have approved the Commission's "indirect" mode of regulating pipelines. In his dissent, Judge Fahy stated that he would have modified the Commission's proposal so as to permit refunds from the small producers to the pipelines and large producers should the Commission find it necessary to protect the purchasers from unreasonably high prices:

> "I would strike its [Order No. 428's] provisions prohibiting refunds to pipelines and producers, leaving open to the Commission to exercise such authority as it has to protect large producers and pipelines. . . ." (FPC Pet., p. 22a).

## INGAA's INTEREST IN THE PROCEEDING

As noted hereinabove, INGAA is a non-profit trade association representing virtually all of the major long-distance natural gas transmission lines (pipelines) in the United States which are subject to the jurisdiction of the Commission under the Natural Gas Act. Most, if not all, of these companies are affected by the Commission's Order Nos. 428 and 428-B here under review and are particularly aggrieved by the Commission's action which purports to shift to the pipeline companies the burden of justifying the prices paid for gas purchased from small producers.

INGAA is keenly aware of, and equally sympathetic to, the Commission's stated objective (App. 137) in this proceeding of assuring the maintenance of adequate gas supplies for the interstate market. In that regard, the shortage of natural gas has been judicially recognized by this Court,[7] and needs no further dis-

[7] *Federal Power Commission* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 626 (1972).

cussion. In view of the growing national gas shortage, INGAA's membership views the Commission's aim of stimulating additional exploration and development of gas reserves for the interstate market as a laudable one. Indeed, we are not aware of anyone who would quarrel with such an objective. Such an objective, however, in no way justifies the Commission's action of exempting small producers from rate regulation under the Act and unlawfully placing pipeline companies at their peril in purchasing gas from small producers. Unless this aspect is eliminated, the Commission's action may well be counter-productive to the announced purpose of assuring adequate gas supplies to the interstate market.

## SUMMARY OF ARGUMENT

It is INGAA's position that the Commission cannot, under the Natural Gas Act, lawfully "regulate" the rates of small producers through the scheme of so-called "indirect" regulation whereby the Commission would force the purchasing pipelines to absorb any portion of the prices paid by pipelines to small producers which the Commission later determined to be "unreasonably high," by eliminating such amounts from the pipelines' costs of service.

INGAA will show that "indirect" small producer rate regulation is not supported by the rate provisions of the Natural Gas Act and, further, that Section 16 classification powers do not give the Commission discretion to regulate in such a novel manner. Moreover, contrary to the Commission's assertions, nothing in this Court's decisions in *Permian, supra,* and *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964), support "indirect" review of small producers' rates. Indeed, this Court has previously rejected the "indirect" approach to producer regulation in its landmark *Phillips* decision, *supra.*

The Commission has imposed a new regulatory burden on the pipelines which goes beyond the general proposition that pipelines must justify the reasonableness of cost of service items. By its orders on review, the Commission has failed in its duty to give meaningful or workable guidance to the pipelines as to the prices which would be allowed in pipelines' costs of service, thereby threatening the financial health of the pipeline companies. This result, we submit, is clearly contrary to the public interest. See *FPC* v. *Memphis Light, Gas & Water Division,* U.S. , 93 S.Ct. 1723 (1973).

Finally, the Commission has other lawful means by which it can further the objective upon which its orders herein are premised (i.e., the dedication of additional gas reserves to the interstate market). Approval of the Commission's action by this Court is, therefore, unnecessary to reach that desired end result.

## ARGUMENT

### THE COMMISSION'S SCHEME OF SO-CALLED "INDIRECT" REGULATION OF SMALL PRODUCERS' RATES IS UNLAWFUL UNDER THE NATURAL GAS ACT.

The Commission's principal tactic on brief to this Court is to assert that the court below failed to comprehend the effect of the Commission's Order Nos. 428 and 428-B here on review (FPC Brief, pp. 13-20). The Commission attempts to cast its action as procedural rather than substantive in nature, arguing that it is simply adopting a different mode of regulation of small producers' rates which is within its administrative discretion. The crux of this new "indirect" method of regulation is that the Commission will determine in pipeline and large producer rate proceedings whether the small producers' prices are "unreasonably high," a standard which the FPC claims is the "full equivalent

of the statutory 'just and reasonable' standard" (FPC Brief, p. 16). The burden of disallowance of any prices determined *ex post facto* by the Commission to be "unreasonably high" would fall ***not on the sellers*** but on the purchasers (here, pipelines and large producers). Thus, the essence of the Commission's argument is simply that so long as it asserts that the ultimate consumers of natural gas will not pay "unreasonably high" amounts for small producers' gas, then it matters not one whit where and how the burdens of such regulation fall.

Despite the Commission's repeated denials that it is effectively deregulationg small producers' rates, the court below characterized the effect of the Commission's orders as the unlawful *non*regulation of the small producers' rates (FPC Pet., p. 16a).

### A. The Provisions Of The Natural Gas Act Do Not Support The Commission's Action.

The Notice of Rulemaking which preceded the promulgation of Order Nos. 428 and 428-B was forthrightly entitled "Exemption of Small Producers from Regulation" (App. 1). The Notice itself nowhere alluded to the scheme of "indirect" regulation which the Commission adopted in Order No. 428 and reasserted in Order No. 428-B. In Order No. 428, the Commission stated:

> "We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no room for administrative judgment and discretion" (App. 136).

The Commission, however, now appears to concede that it is without power to provide an outright exemp-

tion from regulation by stating that it has not asserted any such authority (FPC Brief, p. 18).

**1. The Language of the Statute Requires Regulation of <u>all</u> Rates Subject to the Commission's Jurisdiction.**

Even though the Commission appears to now have discarded its reliance upon the authority it had earlier cited for exempting small producers' rates from regulation, claiming instead that its so-called "indirect" scheme saves the action from constituting an outright exemption, it is nevertheless appropriate to briefly review the pertinent provisions of the statute in order to eliminate any doubt that the language of the Act is permissive or discretionary, as the Commission had suggested earlier.

Section 4(a) provides:

> "*All* rates and charges made, demanded, or received by any natural gas company . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful." (Emphasis supplied.)

Section 4(b) provides:

> "*No* natural gas company shall with respect to *any* transportation or *sale* of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person . . . or (2) maintain any unreasonable difference in rates, charges . . . between classes of service." (Emphasis supplied.)

Section 4(c) provides that:

> ". . . *every* natural-gas company *shall file* with the Commission . . . *schedules showing all rates* and charges *for any* transportation or *sale* subject to

the jurisdiction of the Commission . . ." (Emphasis supplied.)

Section 5 is likewise clear. It provides that:

"(a) Whenever the Commission, after hearing... shall find that *any* rate . . . charged, or collected by *any* natural-gas company . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission *shall determine the just and reasonable rate* . . . to be thereafter observed and in force, and *shall fix the same by order* . . ." (Emphasis supplied.)

It is not surprising, therefore, that the court below found, after reviewing the above provisions, that they are *mandatory* and are applicable to *all* wholesale sales of natural gas in interstate commerce by producers irrespective of their size (FPC Pet., pp. 7a, 8a). In the face of such unequivocal language, it is also understandable that the Commission seeks to both camouflage and justify its action through the device of "indirect" regulation.

**2. Section 16 of the Natural Gas Act Does Not Modify or Diminish the Provisions of Sections 4 and 5 of the Act.**

The Commission places heavy reliance for its actions herein upon the classification powers of Section 16 of the Act, 15 U.S.C. 717o. However, as the Court of Appeals held, the regulatory mandate of Sections 4 and 5 of the Act is in no way circumscribed or diminished by Section 16 classification powers which are designed for administrative convenience, and *not* as a device for expanding, contracting or otherwise changing the coverage of the Act:

"Thus the Commission's power, under Section 16 of the Natural Gas Act, to 'classify persons and

matters within its jurisdiction' and to 'prescribe different requirements for different classes' cannot validate this exemption of small producers. The Commission can only classify '[f]or the purposes of its rules and regulations.' It can only prescribe rules and regulations 'to carry out the provisions of this chapter.' Section 16 thus does not give the Commission independent powers. Rather, *it provides for implementation of the core sections of the Act, such as Section 4.*" (FPC Pet., pp. 9a, 10a). (Emphasis supplied.)

The Court of Appeals correctly concluded that only Congress could effectuate the change in the regulatory scheme sought by the Commission:

> "Only Congress can knowingly prescribe non-regulation for small producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* [*Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954)] to be mandatory under the Natural Gas Act for all producers." (FPC Pet., p. 16a; see also, p. 17a, fn. 25.) [8]

In relying on Section 16 for authority to shift the rate regulatory responsibility from small producers to the pipeline purchasers (FPC Brief, pp. 21-23), the Commission cites its need for flexibility "to make pragmatic adjustments which may be called for by particular circumstances." The court below has correctly noted, however, that the latitude of regulatory agencies such as the FPC is restricted by "the ambit of

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[8] For pending legislative proposals affecting producer regulation under the Natural Gas Act, see e.g., S. 371, S. 1162, S. 1549, S. 2048, S. 2506, S. 2806, H.R. 480, H.R. 2533, H.R. 2866, H.R. 3299, H.R. 3566 H.R. 3685, and H.R. 7507, all 93rd Congress, 1st Session.

[its] . . . statutory authority" (FPC Pet., p. 7a)[9] and that Section 16 does not give the Commission independent powers (FPC Pet., p. 10a). In short, there is no authority within the four corners of the pertinent provisions of the Natural Gas Act which justifies or validates the shift of rate regulatory responsibility as proposed by the Commission.

**B. Prior Interpretations By The Commission And The Courts Do Not Support The Commission's Action.**

It is of significance to note that, in the early days of producer regulation, the Commission's own interpretation of its powers under the Natural Gas Act fully comports with the decision of the court below.

Shortly after the *Phillips* decision, and before the institution of area rate proceedings, the Commission acted to simplify the filings by small producers, relying upon its authority to prescribe different procedures for different classes of regulated companies under Section 16 of the Act. Nevertheless, in so doing, the Commission recognized that the coverage of the Act was *mandatory,* and it stated in Order No. 174-B, 13 FPC 1576, 1577 (1954):

> "5. Some of the petitions urged that the regulations be amended to relieve small producers from the requirements of the statute. *The Act does not provide for exemptions from its requirements,* but

[9] *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 586 (1942); see also *FPC* v. *Louisiana Power & Light Co.,* 406 U.S. 621, 642 (1972):

> "FPC and other agencies created to protect the public interest must be free, '*within the ambit of their statutory authority,* to make the pragmatic adjustments which may be called for by particular circumstances' [citing *Natural Gas Pipeline*]." (Emphasis supplied.)

the regulations for producers are herein revised in Sections 154.91, 154.92, 154.94 and 157.23 to further simplify the filings by small producers." (Emphasis supplied.)

Judicial recognition to the same effect is *Saturn Oil and Gas Company* v. *FPC,* 250 F.2d 61 (10th Cir. 1957), *cert. denied,* 355 U.S. 956 (1958), wherein the Tenth Circuit stated:

> "*There is nothing in the Natural Gas Act which makes its applicability depend on the size* or the integration *of the gas operator.* The Phillips decision holds that the Act applies to *all* wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations." (Emphasis supplied.) 250 F.2d at 66-67.

Thus, the past history of producer regulation fully confirms and underscores the correctness of the decision of the court below that the regulation of *all* jurisdictional rates is mandatory, and that classification power under Section 16 does not provide authority for the Commission's actions herein.

In its Notice of Proposed Rulemaking, in Order No. 428, and in its arguments to the court below, the Commission has attempted to construe this Court's decisions in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) and *FPC* v. *Hunt,* 376 U.S. 515 (1964) as supportive of its attempt to shift rate responsibility from small producers to pipelines. Although counsel for the Commission appear to have abandoned their reliance on *Hunt* in their arguments to this Court, it is clear that these decisions do not support the Commission's action.

In its first area rate proceeding, the Commission provided for special treatment for small producers by exempting them from certain filing requirements under Sections 4 and 7 of the Act. 34 F.P.C. 159, 234, 235 (1965). On review, this Court held in *Permian* that the Commission's separate classification of small producers pursuant to Section 16 powers was consistent with its statutory responsibilities. 390 U.S. at 787. However, as the Court of Appeals noted, the small producers in *Permian* were expressly limited to the "just and reasonable" area rate determined by the Commission under Sections 4 and 5 of the Act. The court below said:

> ". . . the Commission is saying that the whole issue in the lawsuit is no different from *Permian.* That just isn't so. The absence of such a 'just and reasonable' limit *is* the big difference. Order No. 428 not only allows small producers to exceed the reasonable and just area rate ceilings—it allows them to do so on the basis of the free market, which is the antithesis of regulation." (Emphasis in original.) (FPC Pet., p. 11a, fn. 18).

The Commission also cites *Permian* in its brief to this Court for a number of general propositions; for example, it said that the FPC is "not bound to the service of any single regulatory formula" (FPC Brief, p. 21); that the Commission's broad responsibilities "demand a generous construction of its statutory authority" (FPC Brief, p. 23); and that the Commission's efforts here are entitled to a "presumption of validity" *(ibid).* In the context of the *Permian* decision, however, none of these general propositions can be interpreted as supporting Commission action in the instant case which goes far beyond "the ambit of its statutory authority."

Likewise, the Commission's earlier reliance on *dicta* in *Hunt* suggesting that the Commission study NLRB exemption procedures was shown by the Court of Appeals to be inapposite; simply put, the Natural Gas Act, unlike the National Labor Relations Act,[10] does not give the FPC discretion to decline to exercise its jurisdiction over the seller of natural gas by purporting to regulate producer rates at the pipeline-purchaser level.

### C. The Commission's Novel Theory Of So-Called "Indirect" Regulation Is Unfair And Unjust To The Pipelines.

The Commission now appears to concede that it has no power to provide an outright exemption from rate regulation to small producers, by stating that it has not asserted any such authority (FPC Brief, p. 18). In what can only be viewed as an attempt to both camouflage and justify its action, the Commission has turned to the illusory device of "indirect" regulation. But as we have shown, there is no authority whatsoever under the Natural Gas Act for such a novel regulatory approach which, we submit, is unfair and unjust to the pipelines.

The Commission attempts to justify its so-called "indirect" regulation by resort to the fiction that the rates of small producers will continue to meet the statutory "just and reasonable" standard (FPC Brief, p. 13), but this claim would appear to be self-contradictory. As hereinabove noted, the theory of indirect regulation shifts the burden of rate responsibility to the pipeline purchaser. If the rates of the small producer were, indeed, "just and reasonable," then there should be no problem with respect to the pipeline's ability to re-

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[10] 29 U.S.C. 160(a).

cover payments made to small producers as a part of the pipeline's cost of service. Yet, this is precisely the issue that concerns the pipelines in this proceeding, namely, that, at a later date, the Commission may determine that the price is in excess of what the Commission, at that time, determined to be a "just and reasonable" rate and that the pipeline would be required to refund such excesses to its customers.

**1. Contrary to the Commission's Assertion, Its "Indirect" Approach to Rate Regulation Was Reviewed by the Court Below.**

The Commission would have this Court believe that the lawfulness of the "indirect" regulatory method was not reached by the court below (FPC Brief, p. 20). A fair reading of the court's decision, however, leads to the inescapable conclusion that the court examined the *entire* scheme, of which the "indirect" method of regulation was an integral and essential feature, prior to determining that the plan did not satisfy the statutory mandate. In specifically referring to the Commission's "indirect" method of reviewing producer prices, the court below stated:

> ". . . Nothing at all insures that those levels will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a, 13a).

Again, with respect to the concept of "indirect" regulation, the court below forcefully pointed out that regulation and nonregulation are essentially different concepts, and that:

> "It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards. Since the Commission itself has not been confident enough to conclude that the market will necessarily yield rates that comply with the statute, this court can hardly uphold the Orders on that ground." (FPC Pet., p. 14a).

Finally, reference to Judge Fahy's dissenting opinion likewise clearly demonstrates that the "indirect" method of regulation was indeed reviewed by the court below. Although Judge Fahy would have approved the Commission's proposal on an experimental basis, he nevertheless recognized that, under the Act, the Commission should be in a position to protect pipelines and large producers "in the event the Commission finds they have been charged unreasonably high prices by small producers" (FPC Pet., p. 22a). He, therefore, would modify Order No. 428 by striking the provisions prohibiting refunds by small producers to the pipelines and large producers *(ibid)*.

As the above discussion shows, the Commission's characterization of this aspect of Order Nos. 428 and 428-B as undecided by the court below is as unfounded as its assertion that small producers' rates are not deregulated by operation of those orders.

**2. The Commission's Plan Does Not Regulate the Rates of Small Producers.**

As demonstrated hereinabove, Congress has mandated—and the courts have so interpreted—that the Commission shall regulate *all* wholesale sales of gas interstate commerce regardless of the size or classification of the seller. In that connection, Congress clearly intended that the burden of rate regulation should fall directly on the seller, not the buyer. In point of fact, the Commission's "indirect" scheme imposes *no rate burden whatsoever on small producers.*

No amount of strained semantics can conceal the plain fact that small producers have, indeed, been relieved of the statutory "just and reasonable" standard with respect to their rates. There should be no confusion in the Court's mind on this critical point. As Order No. 428 makes clear, a small producer is free to collect whatever contract rate he is able to demand, through negotiation, from a pipeline or large producer purchaser, and the Commission seeks to assure the small producer that the provisions of its contracts will not be subject to change (App. 137; see also, *App.* 249). Furthermore, the small producer would have no obligation to refund any part of the contract price received during the interim period, even if the Commission were to later determine in a pipeline rate proceeding that the contract price exceeded the "just and reasonable" rate (App. 142). By way of example, therefore, a small producer may *receive and keep* his contract price of, say, 60 cents per Mcf even though the Commission were later to determine that a level in excess of 35 cents for that particular transaction was "unreasonably high." Quite clearly, the small producer is free to retain the portion thereof determined

to be "unjust and unreasonable," and the Commission nowhere claims otherwise. The lower court fully comprehended the import of this scheme,[11] and determined that it amounted to *non*regulation in derogation of the mandatory terms of the statute (FPC Pet., pp. 12a, 13a).

Recognizing the obvious infirmities of its position, the FPC belatedly announced that it would retain Section 5 powers to order a *prospective* reduction in small producer rates, thereby limiting what had previously been announced as a total exemption, with concomitant "certainty" of contract prices. But, we submit, this eleventh-hour pronouncement is self-defeating. This *post hoc* effort to instill in its orders a semblance of continuing regulation, which is seen for the first time in the Commission's petition for rehearing to the court below, is wholly at odds with the previously stated ironclad assurance that small producers' contract prices would *not* be subject to reduction and refund. To add, at this late time, the possibility of a reduction in the rates of small producers pursuant to Section 5(a) of the Act only compounds the regulatory uncertainty and risk and will be, therefore, counterproductive to the Commission's entire rationale underly-

[11] The court below took note of the change in the title of Order No. 428 to "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements" from the broader and more forthright title of its Notice of Proposed Rulemaking, "Exemption of Small Producers from Regulation." As the court pointed out (FPC Pet., p. 5a), however, the actual terms of Order No. 428 "belie its title's suggestion that its effect is more limited than that implied by the broad title of the Notice of Proposed Rulemaking." Insofar as its effect on small producers was concerned, the substantive provisions remained unchanged from Notice of Rulemaking to the actual issuance of the rule.

ing the instant rulemaking. Remarkable also is the fact that the Commission, having announced that it intended to retain Section 5 (a) powers, still declined to indicate that it would in fact employ such powers to reduce small producers' rates, prospectively, even when it determines such rates to be in excess of the "just and reasonable" rates (FPC Brief, pp. 15, 31 n. 16). Apparently, the Commission believes that the mere retention of Section 5(a) powers is somehow sufficient, in and of itself, to validate its actions herein.

Even if the Commission were to exercise its Section 5(a) provisions by reducing, prospectively, a small producer's rates, it would not cure the illegal financial burden placed upon the pipeline and large producers for the period commencing with the date of initial delivery until the date, after hearing, upon which the Commission's order reducing the small producer's rate becomes final.[12]

**3. The Commission's Imposition of a New Regulatory Burden on the Pipelines Is Patently Unreasonable and Unfair.**

The Commission argues that its proposal to shift the cost responsibility for small producers' rates to pipelines (and large producers) represents nothing new or unfamiliar under the Natural Gas Act, since "the pipelines' rate base has always been limited to reasonable costs" (FPC Brief, p. 33). As applied to pipelines'

[12] In this connection, it should be noted that the Commission had adopted area rate procedures in an effort to shorten the exceedingly lengthy time which had been required to regulate producers on an individual company basis. Individual 5(a) proceedings against small producers would undercut the administrative progress made as a result of the area rate technique, and the lengthy proceedings would simply prolong the pipelines' exposure to the illegal economic burden placed on them by Order Nos. 428 and 428-B.

purchased gas costs, however, this concept has definite limitations, and runs counter to the Commission's own thinking on the effectiveness of indirect review of producers' rates, subsequent to this Court's decision in the *Phillips* case, *supra.* [13]

First, contrary to the impression which the Commission's statement seeks to convey, the Commission's attempt to shift the burden of small producer rate regulation to an "indirect" review of pipelines' justification of the contractually negotiated prices paid to small producers represents a remarkable departure from prior practice. Before the effective date of the Commission's Orders exempting small producers from rate regulation, the affected producers either had rates on file with the Commission or were subject to area rate ceilings prescribed by the Commission. These rates were the only rates which the purchasing pipelines could legally pay for the purchased gas; having paid the filed or fixed rates, these purchased gas expenses could not be questioned in subsequent pipeline proceedings as to the propriety thereof. See generally, *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), and *Jupiter Corporation* v. *FPC*, 424 F.2d 783, 788 (D.C. Cir. 1969). Thus, the Commission has the responsibility to regulate producer rates *directly;* accordingly, its reliance on the general proposition that pipelines must justify the reasonableness of all expense items is inapposite to the instant situation.

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[13] For the Commission's thinking on this issue prior to *Phillips*, see p. 27, *infra*. It is there shown that this Court rejected the Commission's "indirect" approach to controlling producers' rates.

Second, the Commission's new approach unaccountably ignores its own post-*Phillips* statement bearing on the efficacy of such an "indirect" approach:

> "Control limited to approving the costs of the gas to the purchasing pipelines is, of course, *not an effective way to regulate producer prices because* in the large *a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities.*" [14] (Emphasis supplied.)

Given today's highly competitive market for available gas supplies, it is patently unreasonable for the Commission to hold out the threat of disallowing legitimate purchased gas expense items, which the Commission itself is encouraging the pipelines to incur. By placing the onus of determining what constitutes an "unreasonably high" price upon the pipeline purchasers, without at the same time providing a definitive standard for determining the level or levels of appropriate prices, the Commission is abdicating the responsibility imposed upon it by the Natural Gas Act. Certainly, if the pipelines knew what level or levels would be permissible to pay, there would be neither a complaint by the pipelines nor a reason for deregulation of the small producers. It is only because of the uncertainty of the levels to which such prices will rise (above the previously determined "just and reasonable" levels for the particular producing areas) that the Commission seeks to shift the burden to the pipelines.

In this period of serious natural gas shortage, pipelines are thus placed in an untenable position. As noted

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[14] *Texas Eastern Transmission Corporation, et al.*, 29 FPC 249, 256 (1963), *aff'd sub nom United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

earlier, competition among buyers for the small amount of available gas is very intense. Particularly because the intrastate market is unregulated, the pipelines are under extreme pressure to pay ever-increasing prices for the small amount of gas which is coming to market. Thus, while the basic aim of the pipelines is to acquire additional gas to serve market demands, they are under the constant threat of having their costs disallowed under a vague and unworkable standard.

#### 4. This Court Has Previously Rejected "Indirect" Regulation of Producer Prices.

As far back as 1951, the Commission rendered a decision in which it ruled that Phillips Petroleum Company was not a "natural-gas company" within the meaning of the Natural Gas Act. 10 FPC 246 (1951). In partial justification of its interpretation of the Act, the Commission stated:

> "Likewise, in the exercise of its power to regulate the wholesale rates charged by interstate pipeline companies, this Commission has ample authority to inquire into the reasonableness of all items of operating expense—including the cost of purchased gas—and to disallow, for purposes of rate-making, items of cost which are collusive or otherwise improperly excessive." [15]

Upon subsequent review, this Court, in its landmark *Phillips* decision, flatly rejected the Commission's interpretation of the Act and held:

> ". . . we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by

[15] For the contrary—and better—view, see the *Texas Eastern* decision, quoted at p. 26, *supra.*

a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." (Emphasis supplied and footnote omitted.) 347 U.S. at 682.

In view of the above and the clear language of the Natural Gas Act, it is difficult to comprehend how the Commission now seeks to justify its "indirect" regulatory approach as being "within the ambit of its statutory authority."

As pointed out by the Court of Appeals, the case at bar may present only a part of the problem. The court below was concerned that if what the Commission purported to do in Order No. 428 for small producers were determined to be a reasonable and lawful exercise of its discretion, then the Commission might proceed to provide a similar exemption for "medium" producers (FPC Pet., p. 15a). This concern, no doubt, was heightened by Commission counsel's frank admission at oral argument to the court below that nothing would preclude the Commission from so doing. The court stated:

"... We think it undeniable that the Commission could, under its theory of this case, proceed to establish another class of 'medium' producers, and provide the same or different appropriate exemptions for this new class, and Commission counsel so conceded in oral argument. Likewise, the Commission could, again by its own fiat, change the definition of small producer to include those with greater volumes of jurisdictional sales.

If Order No. 428 is upheld, no limit appears which could halt gradual erosion of the statutory standard's applicability. Given the Commission's self-professed distaste for regulation, a decision upholding its approach here might soon yield further FPC decisions which made the instances where rates were determined by the 'just and rea-

> sonable' standard the exception rather than the rule." (FPC Pet., 15a, 16a).

Carried to its logical extreme, the Commission could eventually purport to regulate *all* producers "indirectly" if its small producer scheme is upheld. Such a result would bring us full circle to the situation existing prior to the *Phillips* decision, and cannot, therefore, be countenanced even in its incipient stages.

### D. The Commission Has Lawful Options To Reach The Same Objective.

The court below, while clearly sympathetic to the Commission's problems and having itself approved previous experimental attempts to deal therewith,[16] recognized that small producers may indeed be entitled to higher "just and reasonable" prices than large producers, given their special problems and practices (FPC Pet., p. 162). Such a determination, the court below concluded, is certainly conceivable within the letter and spirit of the Natural Gas Act *(ibid)*. Such a determination could be based upon supporting record evidence. The pipelines (and the larger producers) would be released from the economic squeeze under Order Nos. 428 and 428-B, since they would then be entitled to recoup the "just and reasonable" prices paid to small producers.

The pipelines are in favor of providing stimuli to producers of all classes and sizes to encourage the finding of gas. Such stimuli, however, should be provided directly, either through lawful administrative action or through new legislation if required; and the pipelines must be protected from loss for the prices they are required to pay for gas if their financial stability is

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[16] See, e.g., *Public Service Commission of New York* v. *FPC*, 467 F.2d 361 (D.C. Cir. 1972).

to be maintained. It will do the public no good to have more gas available in the producing fields and have no viable means of transporting the gas to the consumers. As this Court recently held in *FPC* v. *Memphis Light Gas & Water Division*,—U.S.—, 93 S.Ct. 1723, 1732 (1973).

> "... Under *Hope Natural Gas* rates are 'just and reasonable' only if the consumers' interests are protected and if the financial health of the pipeline in our economic system remains strong."

## CONCLUSION

For all of the reasons set forth hereinabove, INGAA urges this Court to affirm the court below's judgment setting aside Commission Order Nos. 428 and 428-B.

Respectfully submitted,

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January 11, 1974

IN THE SUPREME COURT OF

THE UNITED STATES

OCTOBER TERM, 1973

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NOS. 72-1490,-1491

FEDERAL POWER COMMISSION, PETITIONER

v.

TEXACO INC., ET AL.

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DUDLEY T. DOUGHERTY, ET AL.,
CO-EXECUTORS OF THE ESTATE OF
MRS. JAMES R. DOUGHERTY, ET AL.,
PETITIONERS

v.

TEXACO INC., ET AL.

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ON WRITS OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA

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REPLY BRIEF OF DUDLEY T. DOUGHERTY,
ET AL.

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Respondents attack Order No. 428's scheme of regulation as concerns both flowing gas rates and new gas rates. As to existing sales of flowing gas--gas which was subject to Federal Power Commission jurisdiction at the inception of Order No. 428--it is argued that the order provides no rate regulation of any kind, and hence abrogates the requirement of the Natural Gas Act that the Commission regulate rates of all gas sales. The large producers contend that they are discriminated against in permitting the small producers to collect their contract prices. As to new contracts for flowing gas and as to all new gas, it is argued that the Commission's reliance on variable market criteria is an abdication of its statutory responsibility to insure just and reasonable rates.

1. Contrary to the assertions of several respondents, Order No. 428 does not free all flowing gas sales by small producers from price regulation. Approximately 73.5% of the flowing gas sold by small producers on January 1, 1974, was sold at or below the just and reasonable area rate set by the Commission for such sales.1/ This includes gas (62%) which has been dedicated pursuant to contracts in which the contract rates--which fix the highest price the small producer will

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1/ Foster Associates, Inc., <u>The Impact of Deregulation on Natural Gas Prices</u>, p. 4 (August 1973).

be paid--are below area maxima. It also includes gas (8.6%) sold at prices determined pursuant to spiral escalation clauses, and Order No. 428 limits the rates resulting from such clauses to the appropriate area rate. And it includes gas (2.9%) sold pursuant to expired contracts, which can be sold only at the contract rate unless the Commission approves the small producer abandoning the sale or unless the old purchaser agrees to pay a higher price.2/

Thus, the small producers can receive a rate in excess of the applicable area rate set by the Commission for only approximately 26.5% of the gas presently covered by small producer contracts. Order No. 428 therefore will not result in increases above

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2/ The assertion by PSCNY (Brief at p. 44) that the small producer will be able to obtain the highest large producer or prevailing intrastate market prices when a contract expires is in error. There can be no abandonment of the dedication with the old purchaser unless the Commission approves. See App. 141 n. 4. And the practical effect of the small producer's right to try to renegotiate a higher price with the old purchaser is minimal, since the purchaser knows that unless there is an abandonment the most he will have to pay is the applicable area rate and thus he has no reason to accept a higher price than this. See Dougherty, et al. Brief at p. 22.

applicable area rates in the price paid small producers for all their share of the total interstate sales of natural gas (about 11%). To the contrary, it may result in an increase in the price above those rates for only the 26.5% of small producer gas for which prices can be increased, or about 3% of total interstate sales.

It is the potential increased rates for this 3% share that the Commission determined was just and reasonable, having balanced the need of the consumer for greatly increased supplies of gas at the minimum price necessary to elicit such supplies against the small producer's need for a secure source of exploratory funds in order to furnish such supplies. While there is, to our knowledge, no statistical data available to quantify the impact that increased prices for this fraction of total interstate gas sales might have, the Commission, with whom all small producer contracts are on file, has determined that the impact will be de minimis. To overturn this determination, as respondents urge, on the ground that the Commission did not explain the impact, presupposes that the rate examinations undertaken in the multiple area rate proceedings have not developed ample evidence to

establish this fact.3/

2. The large producer respondents point out that they have entered into contracts to sell gas to their purchasers at a price less than the contract price at which they have agreed to purchase such gas from small producers. They argue that Rule No. 428, by entitling small producers to collect their contract prices, will result in the large producers paying more for such gas than they are entitled to receive upon selling it, and that the Commission's refusal to permit the large producers to pass on this increased cost to their customers improperly discriminates against them.

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3/ The small producers presented ample testimony during the course of this proceeding establishing their important exploratory function in the industry and their need and reliance on flowing gas revenues for drilling funds. Respondent Tenneco, Inc. (Brief p. 45) characterizes this testimony as self-serving. The proceedings before the Commission offered adequate opportunity for Respondent Tenneco to ventilate any conflicting opinions, which it chose not to do. See Phillips Petroleum Co. v. Federal Power Commission, 475 F.2d 842, 850 (10th Cir. 1973), certiorari denied sub nom. Chevron Oil Co. v. Federal Power Commission, 42 U.S.L.W. 3406 (Jan. 14, 1974).

The Commission invited (App. 240) the large producers during the course of this proceeding to make the appropriate proof under Federal Power Commission v. Sierra Pacific Power Co., 350 U.S. 348 (1956), to show that they should be granted relief from their sales contract price limitations. The large producers failed to make such a showing. This avenue is still available to the large producers for relief, if they choose to pursue it.4/ Until they have exhausted their available remedies, they should not be heard to complain about asserted discrimination that is solely attributable to their willingness to contract to pay prices to small producers which they never intended to pay.

3. Respondents also contend that with respect to new gas the Commission is powerless to depart from the traditional rate base approach and to suggest two market criteria which it will

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4/ The large producers' position on this point (see Phillips Petroleum Company Brief, pp. 35-36) demonstrates the effectiveness of Order No. 428's indirect regulatory scheme. The point is made that the large producer or pipeline could negotiate the best possible price with the small producer, but that since all well-head sales have been directly regulated and the price set by the Commission, there has until now been no incentive to do so. Order No. 428, of course, is intended to provide this incentive.

consider in reviewing small producer rates in pipeline rate or tracking proceedings. In Federal Power Commission v. Sunray DX Oil Co., 391 U.S. 9, 25-26 (1968), however, this Court suggested that the variable market price, if it is the "true" market price, would also be the just and reasonable price required under the Act. If, as under Order No. 428, the purchasing pipelines are not freely permitted to pass through their purchased gas costs, but instead are provided an incentive to bargain and hold prices down, the market price resulting from this arrangement reasonably can be expected to achieve the "true" market price which the Court characterized in Sunray as just and reasonable.5/

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5/ Indeed, the basic reason that this Court disapproved the Commission relying on contract prices in setting initial rates was that no incentive existed for gas purchasers to bargain hard for low prices. See Atlantic Refining Company v. Public Service Commission (CATCO), 360 U.S. 378 (1959). Mr. Justice Harlan explained the CATCO decision in the Sunray case (391 U.S. at pp. 25-26):

> *** [T]here can be no assurance that an initial price arrived at by the Commission [based on field prices] will bear any particular relationship to the just and reasonable rate. Any such assurance would necessarily

Of course, bargaining incentives are fundamental to the indirect regulatory system established under Order No. 428. As is manifest from the outcry of the large producer and pipeline purchasers, new and significant responsibilities are being imposed on them. Prior to Order No. 428, these respondents could contract to purchase gas without any obligation to exercise circumspection or even good business judgment as concerns the rates which they agreed, contractually, to pay. These

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5/ Continued

> be based on a belief that the current contract prices in an area approximate closely the "true" market price--the just and reasonable rate. Although there is doubtless some relationship, and some economists have argued that it is intimate, such a belief would contradict the basic assumption that has caused natural gas production to be subjected to regulation and which must have underlain this Court's CATCO decision--namely, that the purchasing pipeline, whose cost of purchase is a current operating expense which the pipeline is entitled to pass on to its customers as part of its rates, lacks sufficient incentive to bargain prices down. (Emphasis added.)

respondents no longer may contract in vacuo concerning rates, for Order No. 428 is the renaissance of viable market forces in the gas producing industry. The Commission's reliance on market forces and the prices resulting in the carefully structured market which Order No. 428 is designed to achieve is no abdication of its regulatory function.

Respondents point out that competition is intense for the short supply of existing gas, and argue that as a result their bargaining powers are curtailed. Gas supplies are indeed limited. But the bargaining burden imposed under Order No. 428 falls equally upon all members of each class of purchaser (large producers and pipelines), and there is no discrimination among members of the same class of purchaser. The small producer sales market is monopsonistic, and absent a pipeline connection their gas is not sold. Due to the inability of the small producer to withhold his product from the market (see Dougherty, et al. Brief, at pp. 24-25), the bargaining power of these purchasers remains paramount and is being exercised effectively to reduce contract rates.

The assertion that it is impermissible for the Commission to impose upon purchasers the duty to bargain for gas because the Commission has heretofore directly set rates is not supportable. This Court in Sunray (391 U.S. at 47-52) sustained the Commission's decision to require

pipelines, rather than the producers, to establish public convenience and necessity for the sale of the gas involved there. Cf. Federal Power Commission v. Louisiana Power & Light Co., 406 U.S. 621, 642-646 (1973). The Commission similarly can require that purchasers, rather than small producers, establish that prices paid for gas are just and reasonable.

The large producers argue that Order No. 428 discriminates against them by giving the small producer an unfair advantage in leasing opportunities. Small producers historically have not leased large tracts such as the large producers desire, with the concommittant large expenditures required, but instead have chosen to spend their funds in exploration. See Dougherty, et al. Brief, pp. 24-25. The large producers' leasing activities therefore are not really threatened under Order No. 428. To the extent there is competition between small producers and large producers for lease acreage and the small producers have additional funds available, by reason of Order No. 428, for this purpose, this advantage is justified by the significantly more intensive and extensive exploratory efforts of small producers, as compared to large producers. Compare Permian Basin Area Rate Cases, 390 U.S. 747, 784-86.

Since significant differences in conditions exist between large producers and small producers, it is within the Commission's discretion to

classify and treat them differently, and such discrimination can be both reasonable and lawful. See United States v. Wabash R. Co., 321 U.S. 403, 411 (1943). The record fully supports that the classification under Order No. 428 is reasonable and that the Commission's allocation of the regulatory burden is consistent with and justified by its responsibility to secure an adequate supply of gas.

## CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed and the orders of the Federal Power Commission should be sustained.

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February 1974

# INDEX

## CITATIONS

# In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 72–1490

FEDERAL POWER COMMISSION, PETITIONER

*v.*

TEXACO, INC., ET AL.

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT*

**REPLY BRIEF FOR THE FEDERAL POWER COMMISSION**

1. The issue in this case is *not* whether the Federal Power Commission can exempt small producer sales from all rate regulation under the "just and reasonable" standard of the Natural Gas Act. The Commission has not claimed such authority, and we do not argue that the statute permits it. The contention (*e.g.*, Phil. 22–26) [1] that the Natural Gas Act requires rate regulation of all producers under the just and reasonable standard is thus beside the point, unless, as some

[1] We use the following abbreviations to signify the briefs of the respondents: "INGAA" (Interstate Natural Gas Association of America); "Phil." (Phillips Petroleum Company); "PSC" (Public Service Commission of the State of New York); "Tenn." (Tennessee Gas Pipeline Company); "Tex." (Texaco, Inc.).

respondents argue and as the court of appeals erroneously concluded, the Commission's order does in fact abandon that standard.

The argument takes several forms. First, some respondents (PSC 18–31; Tenn. 15–16, 27–30), echoing the court of appeals' opinion (Pet. App. 12a), contend that Order No. 428 ties the reasonableness of small producer rates exclusively to two factors that the Commission does not and cannot regulate: "highest contract prices for sales by large producers" and "the prevailing market price for intrastate sales in the same producing area" (App. 142). There is no doubt that the Commission's determination of the reasonableness of small producer rates will depend in part on those field price factors. But, as we showed in our opening brief (pp. 17–19), the order does not mean that those factors are the only ones that will be considered. It states only that the reasonableness determination will include "appropriate comparisons" (App. 140, 142) of the small producer's contract price with the two market factors.[2] The Commission stated that it would "consider *all* relevant factors"[3] (App.

[2] The Court thus need not reach the question whether, as suggested in *Permian Basin Area Rate Cases*, 390 U.S. 747, 795, the Commission could properly conclude in advance that market prices will be deemed "just and reasonable." Nor need it consider whether the present record could support such a determination. To state that the reasonableness of small producers' rates will be reviewed in light of "appropriate comparisons" with prevailing field prices is quite different from saying that the prevailing field prices are in all cases just and reasonable.

[3] The order does not spell out all the factors that may bear upon the reasonableness of a particular rate, but the relevant

142; emphasis added) in making its determination.[4]

Second, it is argued (Phil. 28; Tenn. 12–15) that just and reasonable cannot be the order's standard, because the order contemplates freeing small producers' rates from the constraints of the established maximum area just and reasonable rates. But even the court of appeals recognized (Pet. App. 16a; see also, PSC 30–31) that "just and reasonable" rates for small producers may be at a different level than for large producers. The Commission has not determined in Order No. 428 what that different level will be. But it has indicated that small producers' rates may be

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considerations will not be difficult for sophisticated pipelines and producers to discern. Among the factors may be the producer's costs (which the pipeline is free to ascertain at the time the contract is negotiated), the nationwide average of producers' costs (ranges of which may be found in the Commission's recent rate decisions and in cost submissions in pending rate proceedings), the pipeline's need for the gas, the availability of other gas supplies, the amount of gas dedicated under the contract, the rates of other recent small producer sales in the area that have been approved for flow-through by the Commission, and any other consideration that may suggest the reasonableness of the rate in the particular circumstances. The Commission's early determinations under the order presumably will provide even further guidance.

[4] New York erroneously contends (PSC 22–23) that "all relevant factors" come into play only if the rates are higher than the two market price factors, and that a pipeline would therefore be permitted to pass on even an unreasonably high rate if it were justified by reference to other "factors." There is, however, no basis for that strained interpretation of the order. It plainly contemplates that the other "relevant factors" are to be considered, together with the prevailing field prices, in determining whether a particular rate is unreasonably high. There is nothing to indicate that the Commission will permit *any* unreasonably high rate to be passed on by a pipeline.

reasonable even if they exceed the level that is reasonable for large producers.[5] That determination is a permissible one in view of the unique "problems and public functions of the small producers" (*Permian, supra,* 390 U.S. at 787), and it does not represent a departure from the statutory standard.

Third, some parties contend (INGAA 19–20; Tenn. 14) that, if the order truly guaranteed just and reasonable small producer rates, there would be no need for the pipeline to justify its purchased gas costs before passing them on in the form of higher rates. But that assumes the reasonableness determination must be made in advance of the pipeline's purchase. The scheme of this regulatory plan is to defer the determination to the stage at which the pipeline seeks to flow through its purchased gas costs. If it can show that those costs—*i.e.,* the small producer's rates—are not unreasonably high, it will be permitted to pass them on. If not, it may not pass them on. The result—reasonable rates—is the same; the Act does not require that the Commission's review take place at a prior stage.

Fourth, it is urged (INGAA 22, 24; Phil. 31–32; PSC 37) that the order departs from the statutory standard at least with respect to the rates collected by

[5] Tennessee (pp. 32–33) apparently misunderstands our point to be that the small producer rates will be held to the area maximum. We do not say that. We say that the Commission need *not* establish a single maximum applicable to all producers but may treat different classes differently. Section 16 of the Act, 15 U.S.C. 717*o*, provides that the Commission "may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

a small producer prior to any prospective reduction that may be ordered by the Commission upon a determination that the level is unreasonably high. It is true that small producers will not be required to make refunds for that period, but that is not an abandonment of the just and reasonable standard. The Commission *may* but is never *required* under the Act to order refunds of unreasonable rates (see 15 U.S.C. 717c(e)). *Placid Oil Co.* v. *Federal Power Commission,* 483 F. 2d 880, 905 (C.A. 5), pending on writs of certiorari, Nos. 73-437, 73-457, 73-464; *Public Service Commission of the State of New York* v. *Federal Power Commission,* 329 F. 2d 242, 250 (C.A. D.C.), certiorari denied *sub nom. Prado Oil & Gas Co.* v. *Federal Power Commission,* 377 U.S. 963; see, also, *Permian, supra,* 390 U.S. at 826-828. The Commission determined in Order No. 428 that it would serve the public interest—by allowing small producers to rely on their collected rates in making plans for exploration and by giving pipelines an incentive to bargain hard—to indicate in advance that it would not order refunds of rates collected prior to any prospective reduction. That determination is a reasonable one; it is at the heart of the Commission's regulatory plan for small producers.[4]

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[4] Several respondents argue that the Commission will not make even prospective reductions of rates found to be unreasonably high (INGAA 23-24; PSC 35-36; Tenn. 13, n. 13). They rely on a statement in the order that the Commission seeks "to assure the small producer that * * * the provisions of his contract will not be subject to change" (App. 137). But that statement, read in the context of the entire order, including the Commission's determination to permit the passing on only of

Fifth, two respondents argue (Phil. 30; PSC 42-46) that the Commission's determination to permit the flow through of increases authorized under *existing* small producer contracts without requiring the pipeline to demonstrate that they are not unreasonably high (see App. 246, n. 5), is an unlawful abandonment of the just and reasonable standard with respect to those rates.[7] The Commission, however, is familiar with the rate levels contained in existing contracts (which are required to be filed), and the order simply reflects its judgment that those levels are not unreasonably high. Even so, the order does not foreclose the Commission from adjusting its position in this respect if experience shows that its judgment was incorrect. The Commission intends to monitor closely the results

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reasonable rates, means only that the contract will not be subject to retrospective change by way of a refund order. There is no basis for concluding that the Commission has decided not to exercise its authority to reduce unreasonably high rates. That would leave a pipeline in the position of having to absorb the unreasonable excess over the life of the contract, and there is nothing in the order to suggest that the Commission intends that result.

Nor is this plan "self-defeating" (INGAA 23). The Commission reasonably concluded that the no-refund assurance would adequately stimulate exploratory activity and would provide a sufficient bargaining incentive to the pipelines and large producers.

[7] Neither Phillips nor New York made this claim in its petition for rehearing before the Commission (see App. 214-220, 221-237), "a step required by § 19(b) of the Act in order to preserve a point for judicial review" (*Wisconsin* v. *Federal Power Commission*, 373 U.S. 294, 307). The only contention made by New York with respect to sales under existing contracts was that any increase in the rates for those sales would not effectively stimulate new exploration (App. 217).

of its order and to take whatever further action is necessary "to protect the consumers" (App. 145).[8]

Finally, it is argued (PSC 38–39; Tenn. 42–44) that the standard traditionally applied in pipeline rate proceedings is one of "prudence" rather than "reasonableness," and that the order therefore portends a departure from the statutory standard. Even assuming that there is any substantial difference between a prudent expense and a reasonable one, Order No. 428 makes it entirely clear that reasonableness will be the standard in the context of small producer rates.[9]

2. Several of the respondents contend (INGAA 16–19; Phil. 22–26; Tenn. 16–23, 33–34; Tex. 4–9) that the Natural Gas Act requires that producers' rates be regulated directly and precludes indirect review at the pipeline level. In arguing that direct regulation is required, however, respondents succeed only in showing that some form of effective regulation is required. The Act does not specify the method to be used; it only establishes the result that must be reached. If, as we have shown, the Commission's plan is reasonably de-

[8] New York argues (PSC 44–45) that existing revenues and incentives are adequate to encourage exploration by small producers and that there is thus no reason to permit rate increases authorized under existing contracts. But this is manifestly a judgment for the Commission, and New York has not shown that the Commission's determination that this additional revenue would facilitate further exploratory activity is unreasonable.

[9] The Commission recently suspended a pipeline rate increase based on a new small producer contract under Order No. 428, on the ground that "the contract rate has not been shown to be just and reasonable * * *." *Trunkline Gas Co.*, Dkt. Nos. RP72–23, *et al.*, issued January 31, 1974.

signed to ensure just and reasonable small producer rates, the Act is not offended because the manner of the regulation is not direct.

Similarly, in arguing that the Act provides no authority for indirect, pipeline-level review of producers' rates, respondents succeed only in showing that indirect regulation has not been tried before and that the statute does not spell out in so many words the Commission's authority to try it now. But the Commission is not forbidden to try new methods of regulation designed to serve the public interest more effectively than the old. And the absence of specific authority to undertake a program of indirect review is not a bar to doing so. The Act gives no specific authority to regulate rates directly, either. The fact is, as we have stated, that the statute does not specify any particular method of regulation. That is why "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling" (*Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602).[10]

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[10] There is no merit to the claim (INGAA 27–29; PSC 35; Tenn. 35) that Order No. 428 represents a return to the situation that existed prior to this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, where it was first held that the Commission has jurisdiction over wellhead sales of natural gas in interstate commerce. The Commission's review of the pipeline's purchased gas costs here will be undertaken with an eye not only toward the reasonableness of those costs but also toward the reasonableness of the rates. Unlike the situation prior to *Phillips*, the Commission may order the prospective reduction of any small producer rate found to be unreasonably high.

3. The respondents make a variety of other attacks upon the Commission's order, asserting that it is unreasonable, unfair, discriminatory, vague, impractical, and ineffective. None has merit; most have been answered in our opening brief. We allude here only to those we had not anticipated.

a. The pipelines and large producers complain that the Commission's order discriminates unfairly against them. The pipelines contend (INGAA 25; Tenn. 36–37) that the order is unfair because they had not, since *Phillips, supra,* been required to bear the burden of justifying their purchased gas costs, and that Order No. 428 subjects them to "new risks" (Tenn. 37). They claim it is unfair to impose this "new" burden of keeping their costs to a reasonable level because the current gas shortage "has created a strong sellers' market" (Tenn. 31). As the Commission indicated (App. 245), however, pipelines have always had the burden of demonstrating that their costs—"including the cost of purchased gas" (*ibid.*)—are reasonable. While the regulatory scheme of Order No. 428 places a new "emphasis on that duty" (*ibid.*) with respect to purchased gas costs, that does not give rise to a new risk but only highlights an existing one. It goes without saying that the Commission will not permit any substantial deterioration in the financial health and integrity of the interstate pipelines. If, contrary to the Commission's reasonable expectations, the new regulatory plan leads to any such result, the Commission is free to make the necessary adjustments.

The large producers argue that they are disadvantaged because their contracts may not permit them to pass on the increased costs of gas purchased from small producers, whereas the pipelines will be in a position to do so (Phil. 35–38, 39–40). But that results from the terms of the producers' contracts (which commonly do not allow for tracking increases), not from the Commission's order. The Commission itself, in a separate proceeding under Section 5(a) of the Act, 15 U.S.C. 717d(a), may in appropriate circumstances establish rates higher than those specified in a contract. But it has no authority to permit large producers or pipelines themselves to raise their rates in excess of the maximum authorized in their contracts. *Federal Power Commission* v. *Mobile Gas Service Corp.*, 350 U.S. 332; *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348. That the pipelines have contracts permitting increases while the large producers do not is no reason to invalidate the Commission's order.[12]

b. Tennessee (pp. 39–41, 41–44) claims that the "unreasonably high" standard in Order No. 428 is too vague, and it poses a series of questions in an effort to demonstrate ambiguities. But it is obvious that the

[12] The large producers also claim (Phil. 38–39) that they are competitively disadvantaged because small producers will be in a position to commence sales without waiting for Commission certification. But this is true even now under the existing small producer certificate program, which permits small producers to obtain blanket certificates authorizing in advance any new sales that do not exceed the maximum area rate. See Order No. 308, 34 FPC 1202.

answers to those questions would raise still further questions. The difficulty, if there is one, is inherent in any attempt to apply a general standard in the abstract. The answers to Tennessee's questions, to the extent those questions have practical significance, will become apparent once the program is fully under way and the Commission has had an opportunity to consider the reasonableness of specific small producer rates.

c. Other respondents raise similar objections related to the practical operation of Order No. 428 (INGAA 24, n. 12; Phil. 29; PSC 17, 39-41). But the concern over how the Commission will assess the reasonableness of rates without undertaking a burdensome proceeding in each case is premature. If the Commission finds, after some experience, that the program cannot be managed properly as now established, it will then be in a position to make any necessary adjustments. Similarly, if those who are affected by the order find that its operation raises difficulties not anticipated by the Commission, there is no reason to believe that the Commission will inflexibily resist making appropriate accommodations.

d. Finally, Tennessee contends that Order No. 428 will not accomplish its objective of stimulating exploration (pp. 46-49), that the costs to pipelines and consumers will be disproportionate to the benefits that will result (pp. 49-53), and that the order will not reduce the Commission's administrative burdens (pp. 53-54). These are challenges to the wisdom, not the

lawfulness, of the Commission's determinations. An order may not be invalidated simply because one party or another disagrees with the allowable judgments of the regulatory agency.

Respectfully submitted.

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FEBRUARY 1974.

U.S. GOVERNMENT PRINTING OFFICE: 1974

(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

# SUPREME COURT OF THE UNITED STATES

## Syllabus

## FEDERAL POWER COMMISSION *v.* TEXACO INC., ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 72–1490. Argued February 19, 1974—Decided June 10, 1974*

Following its notice of proposed rulemaking "proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers . . . ," and the filing of comments and informal conferences, the Federal Power Commission (FPC) issued Order No. 428, which exempted all existing and future sales by "small producers" from direct rate regulation, and provided that they could thereunder contract for the sale of their gas at any obtainable rates, without refund obligations with respect to increased rates, if any, collected for sales regulated thereunder to the pipelines. The FPC asserted that the order did not amount to "deregulation of sales by small producers," but intended to regulate small producers' sales in the course of regulating the rates of pipeline and large producer customers of the small producers. Pipelines purchasing from small producers above ceiling prices were to be allowed "tracking increases" in their rates, but those rates would be subject to refund "with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for interstate sales in the same producing area . . . ." The FPC asserted its intention of reviewing small producer prices to maintain reasonable rates and specified that small producers remain subject to § 7 (b) of the Natural Gas Act. The Court of Appeals set aside the FPC order, holding that the small producer blanket certificate procedure

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*Together with No. 72–1491, *Dougherty, Executor, et al.* v. *Texaco Inc. et al.*, also on certiorari to the same court.

Syllabus

contravened the FPC's statutory responsibilities under §§ 4 and 5 of the Act to ensure "just and reasonable rates." It viewed the order as merely calling for rates that were not unreasonably high as compared with the highest contract prices for large producer sales or the prevailing market price in the interstate market, and the court held unacceptable the possible contention that market prices themselves would produce just and reasonable rates. *Held:*

1. The scheme for regulating small producer rates indirectly did not exceed the FPC's statutory authority. Pp. 5–12.

(a) Order No. 428 is not invalid because it does not initially consider each company and the reasonableness of its rates, or because it has a two-tier system for small producers and large producers. Cf. *Permian Basin Rate Cases*, 390 U. S. 747. Pp. 8–9.

(b) Since pipeline rates are subject to refund to the extent that the purchased gas component of their rates is excessive, there is an incentive "to bargain prices down." P. 9.

(c) Requiring the pipelines and the large producers to assume risks in bargaining for reasonable prices from small producers that might entail refunds unrecoverable from the small producers, is not an abuse of the FPC's discretion under § 4 (e) in balancing the interests involved. Pp. 9–11.

(d) It is premature to assert that the indirect regulation contemplated by Order No. 428 is confiscatory, especially since the FPC is to maintain a close review of the avowedly experimental scheme. Pp. 11–12.

2. But it is not clear from the wording of Order No. 428 that it satisfies the statutory requirement that the sale price for gas sold in interstate commerce be just and reasonable; at the least, the order is too ambiguous to satisfy the standard of clarity that an administrative order must exhibit, and the implication that the reasonableness of the small producers' rates would be judged by the assertion that the FPC "would consider all relevant factors" in determining whether the proposed rates comported with the "public convenience and necessity," is insufficient to sustain the order. Pp. 12–16.

3. The FPC lacks authority to rely exclusively on market prices as the final measure of "just and reasonable" rates mandated by the Act; moreover, the FPC order made no finding as to the actual impact the market price increases would have on consumer gas expenditures. Pp. 16–18.

— U. S. App. D. C. —, 474 F. 2d 416, vacated and remanded.

Syllabus

WHITE, J., delivered the opinion of the Court, in which all Members joined, except STEWART, J., who took no part in the consideration or decision of the cases.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

# SUPREME COURT OF THE UNITED STATES

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Nos. 72-1490 AND 72-1491

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| Federal Power Commission, Petitioner, 72-1490 *v.* Texaco Inc. et al. | On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit. |
| Dudley T. Dougherty et al., Co-Executors, Estate of Mrs. James R. Dougherty et al., Petitioners, 72-1491 *v.* Texaco Inc. et al. | |

[June 10, 1974]

MR. JUSTICE WHITE delivered the opinion of the Court.

This case involves the validity of Order No. 428 of the Federal Power Commission, 45 FPC 454 (1971), which provides a blanket certificate procedure for small producers of natural gas, and relieves them of almost all filing requirements. The rates of small producers would no longer be directly regulated but would be subjected to indirect regulation through the review of purchased gas costs of the pipelines and large producers to whom these small producers sell. The Court of Appeals, with one judge dissenting, set aside the order, 154 U. S. App. D. C. 168, 474 F. 2d 416 (1972), concluding that the Commission's order amounted to "deregulation" of small producers and was unauthorized by the Act. Because the validity of the Order is of obvious importance, we granted certiorari filed by the Commission in No. 72-

1490 and by the estate of Mrs. James R. Dougherty, an intervenor in the Court of Appeals, in No. 72–1491. 414 U. S. 817 (1973).

## I

On July 23, 1970, the Federal Power Commission issued a notice of proposed rulemaking "proposing prospectively to exempt from regulation under the Natural Gas Act all existing and all future jurisdictional sales made by small producers . . . ." 35 Fed. Reg. 12,220 (1970). Following the filing of comments and informal conferences, the Commission, noting that one of its important responsibilities was "to assure maintenance of an adequate gas supply for the interstate market," issued order No. 428, aimed at encouraging "small producers [1] to increase their exploratory efforts which are so important to the discovery of new sources of gas . . . to facilitate the entry of the small producer into the interstate market and to stimulate competition among producers to sell gas in interstate commerce." [2] The small producer was to be assured that "when he enters into a new contract for the interstate sale of gas, the provisions of his contract will not be subject to change. We also want to relieve the small producer of the expenses and burdens relating to regulatory matters." Accordingly, the order provided for a nationwide blanket certificate for small producers and relieved them, with some exceptions,

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[1] A "small producer" was defined as an independent producer, not affiliated with a natural gas pipeline company and whose total jurisdictional sales on a nationwide basis, together with sales of affiliated producers, did not exceed 10,000,000 Mcf at 14.65 psia during any calendar year. New small producer sales included any sale made pursuant to a contract dated after March 18, 1971.

[2] The Commission found that small producers produce about 10% of gas purchased by pipelines, excluding all pipelines to pipeline sales. It appears, however, that they also account for 80% of the natural gas exploration in this country.

from all filing requirements under the Act. Unlike large producers, subject to Commission fixed ceilings on rates charged, the small producers could sell gas at the price the market would bear, even though in excess of maximum rates set for producers in pertinent area rate proceedings. Furthermore, they would have "no refund obligations with respect to increased rates, if any, collected for sales regulated hereunder to pipelines . . . ."

The order nevertheless asserted that the "action taken here in our view does not amount to deregulation of sales by small producers" and that the Commission would continue to regulate such sales in the course of regulating the rates of pipelines and large producers to whom the small producers sell their gas. Pipelines purchasing from small producers at prices in excess of existing ceilings were to be permitted to file "tracking increases" in their rates, but those rates would be subject to refund "with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for interstate sales in the same producing area." The issue would be resolved either in pipeline rate cases, a proceeding limited to the tracking increase, or in certificate cases. "The Commission shall consider all relevant factors." Review of tracking increases by pipelines was not anticipated as to existing contracts with small producers; the Order authorized small producers to increase their rates under these contracts, terms permitting.

Large producers buying from small producers would be permitted tracking increases to the extent authorized by their contracts and without refund obligation "as long as the price differential is consistent with prevailing price differentials in the area and as long as the small producer prices for new gas are not unreasonably

high, considering appropriate comparisons with highest contract prices for gas by large producers or the prevailing market price for intrastate sales in the same producing area." To the extent that they reflected small producer prices in excess of that standard, large producer tracking increases would be subject to refund.

The Commission finally asserted that "[w]e intend to review the prices established in new contracts or contract amendments relating to sales by small producers to insure the reasonableness of the rates charged by such producers pursuant to the action we are taking herein. In the event we determine that this approach is inimical to the interest of consumers, we shall take further action to protect the consumers." The Commission apparently remained free to institute separate proceedings under § 5 (a) to reduce the producer's rates prospectively.

The Commission also made clear that small producers remain subject to the requirements of § 7 (b) of the Act with respect to the abandonment of jurisdictional sales, including those sales dealt with in the order. The order also limited the use of indefinite price escalation clauses in small producer contracts and excluded from the reach of the order small producer sales made from reserves transferred by large producers.[3]

The Court of Appeals set aside the Commission order, holding that under the statute *all* natural gas sold in interstate commerce must carry just and reasonable rates and that even if indirect regulation was permissible under the statute, Order 428 was infirm because nothing in it satisfied the Commission's "duty to insure that all rates are 'just and reasonable.'" Instead, the order was

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[3] Subsequently, the Commission issued two supplemental orders, Order No. 428–A, 45 FPC 548, revising the annual statement requirements for small producers and Order No. 428–B, 46 FPC 47, which denied applications for rehearing and modified Order No. 428 in respects that need not be mentioned here.

thought merely to call for rates that were not unreasonably high as compared with the highest contract prices for large producer sales or the prevailing market price in the interstate market—"factors which [the Commission] does not regulate or which derive solely from market forces." Nor could the court accept the possible argument that market forces themselves would produce just and reasonable rates, particularly when it understood the Commission itself to take the position that the just and reasonable standard was in no event mandatory. The Court of Appeals accordingly set aside the Commission's order.

## II

The Commission does not contend in this Court that the Act permits it to exempt small producer rates from regulation or to regulate those rates by any criterion less demanding than the just and reasonable standard mandated by §§ 4 and 5 of the Act. Its major propositions are, first, that Order No. 428, when properly understood, provides for just and reasonable rates but through the means of indirect, rather than direct, regulation; and, second, that the Act does not forbid this kind of indirect regulation. Respondents, on the other hand, contend that the duty imposed by the Act to provide just and reasonable rates cannot be satisfied by indirect regulation and that Order No. 428 in any event abandons the just and reasonable standard with respect to small producer rates.

We face first the issue as to the validity of indirect regulation of small producer rates: on the assumption that Order 428 allows pipelines and large producers to reflect in their rates only just and reasonable charges for gas purchased from small producers, is the order valid? We hold that it is, for we see nothing in the Act which requires the Commission to fix the rates chargeable by small

producers by orders directly addressed to them and which proscribes the kind of indirect regulation undertaken here.

The Act directs that all producer rates be just and reasonable but it does not specify the means by which that regulatory prescription is to be attained. That every rate of every natural gas company must be just and reasonable does not require that the cost of each company be ascertained and its rates fixed with respect to its own costs. Although for a time following *Phillips Petroleum Co.* v. *Wisconsin*, 347 U. S. 672 (1954), the Commission proceeded to regulate rates company-by-company, there was soon a shift to the technique of setting area rates based on composite cost considerations. We sustained this mode of rate regulation.

In *Wisconsin* v. *FPC*, 373 U. S. 294, 309 (1963), the Court affirmed the Commission's decision to abandon the individual cost of service method of fixing rates and to substitute area ratemaking. The Court said that:

> "[t]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates . . . ."

This was wholly consistent with the Court's prior views, see *FPC* v. *Natural Gas Pipeline Co.*, 315 U. S. 575 (1942); *FPC* v. *Hope Natural Gas Co.*, 320 U. S. 591 (1944); *Colorado Interstate Gas Co.* v. *FPC*, 324 U. S. 581 (1945), and reaffirmed the principle which had been clearly stated in the *Hope* case: "Under the statutory standard of 'just and reasonable' it is the result reached

not the method employed which is controlling." 320 U. S., at 602.

The principles of these prior cases were recognized and applied in the *Permian Basin Rate Cases*, 390 U. S. 747 (1968), where we sustained a two-tier system of rates for natural gas producers. In the course of doing so, we recognized that encouraging the exploration for and development of new sources of natural gas was one of the aims of the Act and one of the functions of the Commission. The performance of this role obviously involved the rate structure and implied a broad discretion for the Commission. The Court summarized the principles controlling the judicial review of Commission orders in terms very pertinent here:

> "The Act was intended to create, through the exercise of the national power over interstate commerce, 'an agency for regulating the wholesale distribution to public service companies of natural gas moving interstate'; *Illinois Gas Co.* v. *Public Service Co.*, 314 U. S. 498, 506; it was for this purpose expected to 'balanc[e] . . . the investor and the consumer interests.' *FPC* v. *Hope Natural Gas Co., supra*, at 603. This Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred; see, *e. g., Piedmont & Northern R. Co.* v. *Comm'n*, 286 U. S. 299; *Phelps Dodge Corp.* v. *Labor Board*, 313 U. S. 177, 193–194; *National Broadcasting Co.* v. *United States*, 319 U. S. 190; *American Trucking Assns.* v. *United States*, 344 U. S. 298, 311. Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.
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> "Such a construction is consistent with the view of administrative rate making uniformly taken by

> this Court. The Court has said that the 'legislative discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself.' *Los Angeles Gas Co.* v. *Railroad Comm'n*, 289 U. S. 287, 304. And see *San Diego Land & Town Co.* v. *Jasper*, 189 U. S. 439, 466. It follows that rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, 'to make the pragmatic adjustments which may be called for by particular circumstances.' *FPC* v. *Natural Gas Pipeline Co.*, *supra*, at 586." 390 U. S., at 776–777.

It followed that Commission action taken in the pursuit of a legitimate statutory goal enjoyed the presumption of validity, 390 U. S., at 767, and that he who would upset the rate order under the Act carries "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *Ibid.*

Accepting these views of our role as a court sitting in review, we cannot at this point say that the Commission has exceeded its powers by instituting a regime of indirect regulation of small producer rates. Surely it is not fatal to Order No. 428 that it does not, as an initial matter, consider the costs of each company and the reasonableness of its rates. Nor is the order vulnerable because there will be one level of just and reasonable rates for small producers and another for large producers. The Court approved two sets of just and reasonable rates in the *Permian Basin* case, the justification being the necessity to stimulate exploration for and the development of new supplies of natural gas. *Id.*, at 796–797.

Indirect regulation through the mechanism of controlling large producer costs will not merely recreate the situation which the Court in the *Phillips* case found to be inconsistent with the Natural Gas Act. In the pre-*Phillips* era, although asserting the right to pass on the prudentiality of various items of the pipelines' cost, the Commission did not purport to regulate the rates of producers with the aim of keeping them within just and reasonable limits, as the Commission now asserts it is doing under Order No. 428.

It is argued that permitting the small producers initially to charge what the market will bear and relying on later regulation of pipeline rates to protect the consumer is contrary to *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U. S. 378 (1959) (CATCO). But pipelines and large producers must file with the Commission their new contracts with the small producers, and their rates will be subject to suspension and refund within the limits set out in Order No. 428. As the Court noted in *FPC* v. *Sunray DX Oil Co.*, 391 U. S. 9, 25–26 (1968), the basic assumption which must have underlain the Court's CATCO decision was "that the purchasing pipeline, whose cost of purchase is a current operating expense which the pipeline is entitled to pass on to its customers as part of its rates, lacks sufficient incentive to bargain prices down." Here, on the other hand, the incentive is provided—pipeline rates are subject to refund to the extent that the purchased gas cost component of their rates is excessive.

This leads to the contention of the pipelines and the large producers that the scheme of indirect regulation envisioned by Order No. 428 unfairly subjects them to the risk of later determination that their gas costs are unjust and unreasonable and to the obligation to make refunds which they cannot in turn recover from the small produc-

ers whose rates have been found too high.[4] But those whose rates are regulated characteristically bear the burden and the risk of justifying their rates and their costs. Rate regulation unavoidably limits profits as well as income. "The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid." *FPC* v. *Hope Natural Gas Co., supra,* at 320 U. S. 601. All that is protected against, in a constitutional sense, is that the rates fixed by the Commission be higher than a confiscatory level. *FPC* v. *Natural Gas Pipeline Co., supra,* 315 U. S., at 585. In the context of the Natural Gas Act's rate regulation, whether any rate is confiscatory, or for that matter "just and reasonable," can only be judged by "the result reached, not the method employed." *FPC* v. *Hope Natural Gas Co.,* 320 U. S., at 602. In the *Permian Basin Area Rate Cases, supra,* 390 U. S., at 769, we stated a truism of rate regulation: '[r]egulation may, consistently with the constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness."

Here, requiring pipelines and the large producers to be at their risk in bargaining for reasonable prices from small

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[4] The large producers also contend that they are put at a disadvantage by the Commission's order because their contracts may not permit them to pass on the increased costs of gas purchased from small producers, whereas the pipelines will be in a position to do so. This is, however, a function of the producers' contracts, and the Commission has no authority, absent a finding that the existing contract rate "is so low as to adversely affect the public interest," to permit large producers or pipelines to raise their rates in excess of the maximum authorized in their contracts. *FPC* v. *Sierra Pacific Power Co.,* 350 U. S. 348, 355 (1956); *FPC* v. *Mobil Gas Service,* 350 U. S. 332 (1956). We think other claims of the large producers, as to unfair treatment or discrimination, are equally ill-founded.

producers is within the Commission's discretion in working out the balance of the interests necessarily involved. The consumer would be protected from current excessive rates, but at the expense of the pipeline, rather than the producer, who is engaged in necessary exploratory activity, thus serving the public interest in getting greater gas production but at just and reasonable rates. Under such circumstances, it is surely not an abuse of the discretion the Commission retains under § 4 (e) of the Act, see *Permian Basin Area Rate Cases, supra*, 390 U. S., at 826-827, to refrain from imposing a refund obligation on the small producers.

Any broadside assertion that indirect regulation will be confiscatory is premature. The consequences of indirect regulation can only be viewed in the entirety of the rate of return allowed on investment, and this effect will be unknown until the Commission has applied its scheme in individual cases over a period of time. Moreover, the "regulation of producer prices is avowedly still experimental," 390 U. S., at 772, and Order No. 428 asserts the Commission's intention to keep the experiment under close review. The Commission claims and is entitled to no license to be arbitrary or capricious in disallowing purchased gas costs of large producers and pipelines. The Commission may not exceed its authority under the Act, its orders are subject to judicial review, and reviewing courts must determine whether Commission orders, issued pursuant to indirect regulation, are supported by substantial evidence and whether it is rational to expect them "to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risk they have assumed, and yet provide appropriate protection to the relevant public, both existing and foreseeable." *Ibid.*

If, in the course of the necessary bargaining with small producers, the large producers and the pipelines are given

no guidance whatsoever as to what the standards of the Commission may be, the risk of incurring unrefundable expenses that may later be disallowed is considerably enhanced. The scope of this possible difficulty is measured by the standards, or lack of them, by which the Commission will review the purchased gas costs of the large producers and the pipelines. As Order No. 428 reveals, the Commission is surely aware of the problem, and we would expect additional attention to be given this question in the course of the remand proceedings which, as explained in Part III, we think it necessary in this case.[5]

## III

We turn now to whether Order No. 428 is invalid for failure to comply with the Natural Gas Act's requirement that the sale price for gas sold in interstate commerce be just and reasonable. The Court of Appeals rejected what it apparently understood was "the Commission's basic contention all along that the 'just and reasonable rate standard' was not mandatory and that the FPC can simply choose not to regulate rates." Whatever the position of the Commission heretofore has been, it wisely does not challenge that aspect of the Court of Appeals judgment. Sections 4 and 5 of the Natural Gas Act require that all gas rates be just and reasonable; and the Court held in *Phillips* that this very prescription applies to the rates of all gas producers. The Commission may have great discretion as to how to insure just and reasonable rates, but it is plain enough

[5] New York Public Service Commission also questions whether it is administratively feasible for the Commission, on review of individual pipelines' costs, to make sure rates are just and reasonable, claiming that this would be a return with a vengeance to the administrative morass which led to the adoption of area rates for producers in the first instance. This claim is also premature in light of possible regulatory approaches the Commission may take on remand.

to us that the Act does not empower it to exempt small producer rates from compliance with that standard.

Section 16, upon which the Commission relies is not to the contrary. It authorizes the Commission to perform any and all acts and to issue any and all rules and regulations "as it may find necessary or appropriate to carry out the provisions of this Act"; and "[f]or the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." But § 16 obviously does not vest authority in the Commission to set unjust and reasonable rates, even for small producers. It does not authorize the Commission to set at naught an explicit provision of the Act. No producer is exempt from §§ 4 and 5. Neither the *Permian Basin Area Rate Cases* nor *Louisiana Power & Light Co.*, 406 U. S. 621 (1972), on which the Government relies, suggests or holds that § 16 permits the Commission to ignore the specific mandates of those sections.[a]

The Court of Appeals also read Order No. 428 as failing to provide a mechanism for insuring that small producer rates will be just and reasonable. In its view, the order provided a pure market standard for the approval of the purchased gas costs of large producers and pipelines, a standard which fell short of the requirements of the Act. Accordingly, it set aside the order.

The Commission does not assert here that it is free under the Act to equate just and reasonable rates with the prices for gas prevailing in the market place. Its major remaining contention is that the Court of Appeals

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[a] The Commission's position is not advanced by *FPC* v. *Hunt*, 376 U. S. 515, 527 (1964). The Court in that case merely questioned whether exemption might prove, after study, to be an available alternative.

misread Order No. 428 and that the order, properly understood, contemplates a scheme of indirect regulation that would assure just and reasonable small producer rates for natural gas and that would judge small producer rates not only by market factors but by all the relevant considerations necessary to arrive at the considered judgment contemplated by the Act. For present purposes, then, the United States accepts the Court of Appeals' construction of the Act; but insists that the order is consistent with the statute as so construed.

In this posture of the case, we think it clear that Order No. 428 cannot stand in its present form and that the case should be remanded for further proceedings before the Commission. We have studied the order with care, and we cannot accept the construction of it that the Commission now presses upon us. At the very least, the order is so ambiguous that it falls short of that standard of clarity that administrative orders must exhibit. The Commission was bound to exercise its discretion within the limits of the standards expressed by the Act; and "for the courts to determine whether the agency *has* done so, it must 'disclose the basis of its order' and 'give clear indication that it has exercised the discretion with which Congress has empowered it.'" *Burlington Truck Lines* v. *United States*, 371 U. S. 156, 167–168 (1962), quoting in part from *Phelps Dodge Corp.* v. *Labor Board*, 313 U. S. 177, 197 (1941). We shall indicate briefly our basis for this conclusion.

In the first place, Order No. 428 does not expressly mention the just and reasonable standard. It comes no closer than to subject pipeline rates to reduction and refund "only as to that part of the rate which is *unreasonably* high considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales . . . ." (Emphasis added.) The order took a very similar approach to the

tracking increases by large producers. Moreover, under the order, contractually authorized increases in rates for flowing gas under existing contracts could be automatically passed through by the pipelines and would not be subject to examination under the standard proposed by the order with respect to new sales by small producers. There was no finding that these contemplated increased rates for flowing gas would be just and reasonable. The Commission merely asserts in its brief here that it was familiar with the existing contracts and must have considered the rates reserved to be acceptable under the Act.

It is true that pipeline and large producer costs for new small producer gas were not to be "unreasonable" but the implication appears to be that reasonableness would be judged by the standard of the market place. It is also true that the Commission asserted that it was not deregulating small producer rates, that the Commission "shall consider all relevant factors" in determining whether proposed rates were consistent with the "public convenience and necessity" and that the Commission intended to review new contract prices charged by small producers "to assure that the reasonableness of the rates charged by those producers pursuant to the action we are taking herein." But these generalities do not supply the requisite clarity to the order or convince us that it should be sustained.

Had the order unambiguously provided what the Commission now asserts it was intended to provide,[7] we would have a far different case to decide. But as it is, we cannot "accept appellate counsel's *post hoc* rationalizations for

[7] The Commission, in its brief, has indicated that the standard will not be limited to comparisons with appropriate market prices, but will include (1) producer's costs, (2) the pipeline's need for gas, (3) the availability of other gas supplies, (4) the amount of gas dedicated under the contract, and (5) the rates of other recent small producer sales previously approved for flow through.

agency action"; for an agency's order must be upheld, if at all, "on the same basis articulated in the order by the agency itself." *Burlington Truck Lines, supra,* 371 U. S., at 168–169; *Securities & Exchange Commission* v. *Chenery,* 332 U. S. 194, 196 (1947).

## IV

For the purposes of the proceedings that may occur on remand, we should also stress that in our view the prevailing price in the market place cannot be the final measure of "just and reasonable" rates mandated by the Act. It is abundantly clear from the history of the Act and from the events that prompted its adoption that Congress considered that the natural gas industry was heavily concentrated and that monopolistic forces were distorting the market price for natural gas.[8] Hence, the

[8] As appears from § 1 (a) of the Act, 15 U. S. C. § 717 (a), the legislation stemmed from the 1935 Report of the Federal Trade Commission. Sen. Doc. No. 92, Pt. 84–A, 70th Cong., 1st Sess. (1935). That report concluded that there was heavy concentration both in the production and distribution of natural gas. "The 4 largest producer groups account for about 72 percent of the output of natural gas produced by 32 holding company groups in 1930." *Id.,* at 589. The heavy concentration of pipeline ownership "accentuates whatever control the pipeline interests have of the available gas supply." *Id.,* at 590. The Commission concluded, on the basis of its detailed investigation of the industry, that "[t]he prime characteristic of the situation described is that of a steadily developing concert of interests dominating the producing, transporting, and distributing branches of the industry." *Id.,* at 600. The heart of the problem was at the pipeline end, since the concentration of ownership there allowed the concert of interests "to determine the amount of natural gas which may be marketed by fixing the amount which may be transported. This in turn gives it power to say how much shall be produced." *Ibid.* Based upon these findings, the Commission singled out as "Specific Evils Existing in the Natural Gas Industry" both the "[u]nregulated monopolistic control of certain natural-gas production areas" and the "[u]nregulated control of pipe-

necessity for regulation and hence the statement in *Sunray DX, supra,* 391 U. S., at 25, that if contract prices for gas were set at the market price, this

> "would necessarily be based on a belief that the current contract prices in an area approximate closely the 'true' market price—the just and reasonable rate. Although there is doubtless some relationship, and some economists have urged that it is intimate, such a belief would contradict the basic assumption that has caused natural gas production to be subjected to regulation . . . ." (Footnote omitted.)

In subjecting producers to regulation because of anticompetitive conditions in the industry, Congress could not have assumed that "just and reasonable" rates could conclusively be determined by reference to market price. Our holding in *Phillips* implies just the opposite. This does not mean that the market price of gas would never, in an individual case, coincide with just and reasonable rates or not be a relevant consideration in the setting of area rates, see *Permian Basin Area Rate Cases, supra,* 390 U. S., at 793–795; they may certainly be taken into account along with other factors, *Austral Oil Co.* v. *FPC,* 428 F. 2d 407, 441 (CA5), cert. denied, 400 U. S. 950 (1970). It does require, however, the conclusion that Congress rejected the identity between the "true" market and the "actual" market price.

The Court is not unresponsive to the special needs of small producers who play a critical role in exploratory efforts in the natural gas industry and ameliorating the supply shortage. The requirements of the Act, however, do not distinguish between small and large producers with respect to just and reasonable rates. Even if the

line transmission and of wholesale distribution." *Id.,* at 615. It concluded that regulation, at least of pipelines, see *id.,* at 616, was required.

effect of increased small producer prices would make a small dent in the consumer's pocket, when compared with the rates charged by the large producers, the Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted. Moreover, there is no finding in the Commission's order as to the actual impact the projected market price increases would have on consumer expenditures for gas, and the Commission is previously on record in its *Permian* decision, as stating: "the impact of small producer prices on consumers is by no means *de minimis* on an area basis and is of great impact in some instances." 34 F. P. C. 159, 235 (1965).

## V

In concluding that the Commission lacks the authority to place exclusive reliance on market prices, we bow to our perception of legislative intent. It may be, as some economists have persuasively argued,[9] that the assumptions of the 1930's about the competitive structure of the natural gas industry, if true then, are no longer true today. It may also be that control of prices in this industry, in a time of shortage, if such there be, is counterproductive to the interests of the consumer in increasing the production of natural gas. It is not the Court's role, however, to overturn congressional assumptions embedded into the framework of regulation established by the Act. This is a proper task for the

[9] See C. Hawkins, Structure of the Natural Gas Producing Industry, and P. W. MacAvoy, The Regulation-Induced Shortage of Natural Gas, in Regulation of the Natural Gas Producing Industry 137–191 (1972) (K. Brown, ed.). See also Statement of John N. Nassikus, Chairman, Federal Power Commission, Hearing on The Natural Gas Industry before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, 93d Cong., 1st Sess., 43–72 (1973).

legislature where the public interest may be considered from the multifaceted points of view of the representational process.

Attempts have been made in the past to exempt producers from the coverage of the Act, but these attempts have been unsuccessful. The Court realized as much in the *Phillips* case. 347 U. S., at 685 and n. 14. In 1950, Congress had passed a bill, H. R. 1758, to exempt gas producers from the Act, but President Truman vetoed the bill stating "there is a clear possibility that competition will not be effective, at least in some cases, in holding prices to reasonable levels. Accordingly, to remove the authority to regulate, as this bill would do, does not seem to me to be wise public policy." The President made this judgment despite the arguments that imposition of price control would discourage exploration and development of new wells. Public Papers of President Truman 257 (1965). For the Court to step outside its role in construing this statute, and insert itself into the debate on economics and the public interest, would be an unwarranted intrusion into the legislative forum where the debate again rages on the question of deregulation of natural gas producers.

We do, however, make clear that under the present Act the Commission is free to engage in indirect regulation of small producers by reviewing pipeline costs of purchased gas, providing that it insures that the rates paid by pipelines, and ultimately borne by the consumer, are just and reasonable. It may be, as some of the respondents suggest, that ensuring just and reasonable rates by means of indirect regulation will not be administratively feasible, but this is a matter for the Commission to consider.

We agree with the Court of Appeals that the order of the Commission must be set aside; but for reasons previously stated, we vacate the judgment of the Court of

Appeals and remand the case to that court with instructions to remand the case to the Commission for further proceedings consistent with this opinion.

*Vacated and remanded.*

MR. JUSTICE STEWART took no part in the consideration or decision of these cases.